

22 July 2016

Australian Securities & Investments Commission
Attn: Richard McMahon
Level 5, 100 Market Street
SYDNEY
NSW 2000

BY EMAIL: innovationhub@asic.gov.au

Dear Mr McMahon

RE: CP260: FURTHER MEASURES TO FACILITATE INNOVATION IN FINANCIAL SERVICES

The Financial Services Council welcomes the opportunity to make a submission to ASIC in regards to 'Consultation Paper 260: Further measures to facilitate innovation in financial services' (**CP260**).

The Financial Services Council (**FSC**) has over 115 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than \$2.6 trillion on behalf of 11.5 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC commends ASIC for its promotion of innovation in the financial services sector, however we contend that there should be a focus on the promotion of competitive neutrality across the industry. We propose that the regulatory exemption sandbox be made available to all participants in the sector; from large institutions adapting to the digital environment to start-ups disrupting the sector.

In Appendix A we outline our comments in response to the invitation to make a submission as to innovation in the FinTech sector.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,



JENNA MOLLROSS

Policy Manager – Investments & Global Markets

APPENDIX A

CONSULTATION PAPER 260: FURTHER MEASURES TO FACILITATE INNOVATION IN FINANCIAL SERVICES

GENERAL COMMENTS

The FSC commends ASIC for its promotion of innovation in the financial services sector, however we contend that there should also be a focus on the promotion of competitive neutrality across the industry. We propose that the regulatory exemption sandbox be made available to all participants in the sector; from large institutions adapting to the digital environment to start-ups disrupting the sector.

The FSC is generally supportive of the concepts outlined in CP260, however we would like ASIC to ensure that a level playing field is maintained across the industry. Allowing start-ups special treatment may provide an unfair advantage, for example, the ability operate without the burden of regulatory requirements that existing players must already meet. ASIC should have regard to ensuring that latitude is also be provided to existing players moving into new/innovative FinTech areas. We do not believe that it is appropriate that unlicensed entities be able to operate without the burden of a licence merely because they are a start-up.

The FSC proposes that existing AFSL-holders also receive access to the regulatory sandbox exemption where they would like to test a new product/service which falls outside the scope of their existing licence. The FSC also urges ASIC to also consider streamlining or fast-tracking the process for existing licensees to obtain ASIC relief in regards to barriers to innovation.

The FSC supports the measures designed to assist start-ups in determining their obligations and navigating the regulatory requirements, however extra guidance by ASIC is also supported.

Recommendation: That the regulatory sandbox exemption be extended so as to be accessible to existing licence holders to test products/services currently outside the scope of their AFSL.

In addition, to ensure a level playing field and to encourage innovation by all players, we suggest that the regulatory sandbox concept be expanded to include a broader nimble and flexible pilot program to allow existing licensees to more quickly test whether a new idea meets the expected customer needs and is commercially viable. This will result in ASIC obtaining actual data to assess whether permanent regulatory relief is justified.

It is suggested that the pilot program be flexible and principles-based to allow different approaches to be taken for different ideas being piloted.

We envisage that a licensee would approach ASIC with an innovative product or service and the licensee and ASIC would:

1. Agree the temporary regulatory relief needed to efficiently test if the concept improves customer outcomes and is commercially viable;
2. Agree the conditions that will apply to the pilot;
3. Agree the length of the pilot;
4. Agree how the success of the pilot will be measured (for the licensee and for ASIC when considering whether to give more permanent relief); and

5. Agree the exit strategy for customers in the pilot (if the pilot is not successful).

Towards the end of the pilot period, ASIC and the licensee would agree whether:

1. The pilot should be extended (e.g. to collect more data);
2. The pilot did not meet its objectives and should be stopped and the exit strategy implemented;
3. The pilot was successful but no permanent regulatory relief is justified. To move beyond the pilot, the licensee would need to fully comply with existing financial services laws; or
4. The pilot was successful and permanent regulatory relief should be given. That relief could be limited to that licensee or product or be extended to the industry generally.

The principal advantages of this approach would be:

- To recognise that some parts of the existing regulatory regime can be a barrier to some innovation ideas. This could be because the regulatory regime prevents that activity or because compliance with some parts of that regime can be a significant cost to a licensee at a time, when it is unknown if the idea will be successful. This allows the licensee and ASIC to agree a “regulatory light” approach where it makes sense to do so in order to test the benefits of a new idea.
- Allows an innovative idea to be tested with real customers with collection of verifiable evidence of benefits (or otherwise).
- Agility and time efficiency – the expectation is that a pilot should be able to be agreed by ASIC and the licensee in a fairly short time frame allowing an innovative idea to be tested and refined.
- ASIC would have the benefit of the pilot results to help it assess the customer benefits of a new idea (and hence, the merit in giving more permanent relief from some regulatory provisions to allow that idea to be efficiently delivered to customers)

SPECIFIC COMMENTS RE CONSULTATION QUESTIONS

MEASURES CONSIDERED IN THE CONSULTATION PAPER

A1Q1 Do you agree that we should put in place additional measures to facilitate innovation, or maintain the status quo? Please provide reasons.

ASIC, in consultation with industry, should consider adding additional measures to facilitate innovation (such measures are further outlined in A1Q4 below). Innovation is in the best interests of consumers at large as it drives choice. However, it is key to ensure that adequate protections are in-place.

The ‘access to capital’ question has been considered but there also needs to be consideration given to the ongoing sustainability of this capital and the revenue models of innovators. In particular, we note that under Option 3 (Section 31) of CP260, there is no explicit consideration as to who will provide protection or guarantees to consumers using the financial services which are being tested without a licence.

As noted in our General Comments section above, access for existing Australian businesses/AFSL holders to test in the same manner as 'new' Australian businesses needs to be a part of the regulatory sandbox to ensure competitive neutrality. Without access for existing businesses in addition to new, then innovation as a driver of consumer choice is negated and limits the ability to test innovative financial services and products to only a small number from the large pool of possible businesses, ideas and entrepreneurs.

A1Q2 What benefits do you consider will result from our proposed approach?

Benefits of greater guidance to Responsible Managers will assist the balance of consumer choice and consumer protection (from innovation). This greater guidance needs to be easily accessible and well-articulated to new Australian businesses as part of facilitating greater innovation.

A1Q3 What disadvantages do you consider will result from our proposed approach?

As noted in the A1Q1 response above, the disadvantages would include not currently being explicit in whether the regulatory sandbox is available to incumbent organisations who are also driving innovation, as well as potential disadvantages in regards to the need to carefully balance innovation with consumer protection. In addition, considerations need to be had as to robustness of capital and the provision of deeper guidelines as to the development of revenue models of new businesses.

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?

It is our observation that the paper is more aligned to facilitate disruption to established financial institutions with limited focus on helping to enable established financial institutions partner with FinTech businesses in the ecosystem. We would support a similar sandbox regulatory approach being applied to new services that established financial institutions are providing (outside of their current AFSL licensing parameters), whether that be via in an house technical build or via partnership with new FinTech start-ups or more established third party technology providers.

We suggest ASIC consider establishing innovation meetings, with both disruptors and incumbents represented, which could be similar to:

- The approach in Singapore, where industry wide solutions are used to tackle issues such as blockchain, identity, payments, aspects of cyber-security, asset registers, open bank APIs and the further use of cloud technology; and/or
- Those orchestrated by the Federal Government's FinTech Advisory Group, which seem to be working well to surface innovation challenges for genuine industry debate and has allowed for productive conversation.

These types of meetings may be of considerable assistance to innovators and the regulator for boarder context and understanding.

ADDITIONAL GUIDANCE ON ASSESSING KNOWLEDGE AND SKILLS UNDER OPTION 5 OF RG 105

In regards to the changes to the Responsible Manager selection processes; it is stated that ASIC does not intend to change the Regulatory Guides but our members have indicated that these will still need

to be considered in an organisation's executive recruitment processes as licencing management policies typically fall under the group compliance function, rather than discrete departments.

B1Q1 Do you agree with this proposal? Please give reasons for your answer.

Yes, the FSC agrees with this proposal (refer to A1Q2 above for further detail).

NOMINATING RESPONSIBLE MANAGERS

B2Q1 Do you agree with this proposal? Please give reasons for your answer.

Yes, subject to feedback in B3Q2 below.

REQUIREMENTS FOR THIRD-PARTY SIGN-OFF

B3Q1 What sort of sign-off should a third-party responsible manager be required to provide?

We recommend that third-party Responsible Managers be expected to lodge a formal sign-off with ASIC that comprehensively covers each of the following: product use/take-up, any changes in function, consumer feedback, complaint volume (if appropriate) and compliance with obligations.

B3Q2 Is an annual sign-off appropriate?

An annual sign-off is not frequent enough in this type of environment, particularly noting that the regulatory sandbox exemption is only for a six month period. We would recommend that as a minimum a twice yearly sign-off (and preferably every four months) be required given the frequency of change and progress in product development by the new business.

CONDITIONS OF ELIGIBILITY FOR THIRD-PARTY SIGN-OFF

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?

We agree that the proposed restrictions are appropriate as they still allow a significant amount of flexibility. However, the client number threshold needs to be more deeply considered; 1,000 would be the maximum, but the knowledge, understanding and level of education provided to any customers is the more critical part and should be given adequate consideration. Is there another threshold in addition to maximum number of clients that can be applied? One suggestion would be to apply an overlay consideration of credit scoring, another could be amount of education provided by the product provider or a maximum dollar amount that an individual customer can invest/commit to the product.

B4Q2 Are other restrictions—such as an exposure limit on investment products—also warranted?

Yes, see above comments

SIX MONTHS OF UNLICENSED FINANCIAL SERVICE TESTING WITH RETAIL CLIENTS

C1Q1 Do you agree with this proposal? Please give reasons for your answer.

The FSC supports this proposal, subject to ensuring that there is significant communication to consumers to limit any poor consumer outcomes. This would be best done by ensuring all activities are limited to 'Concept' stage only and that there is a strong understanding of what 'Concept' testing and consumer engagement means. ASIC should consider issuing guidelines as to the definition of 'Concept Validation' to ensure that businesses are well-informed and consumer interests are protected.

We also propose that the six month exemption period should be followed by a transitional period in which the FinTech business would apply for its AFSL. Where an established business is looking to provide a new service that may require onerous or uncertain regulatory impacts to its licence, we would suggest a similar six month sandbox exemption be afforded to these players.

If there is no transition period then there will be a gap between the end of a product/service pilot and the ability to provide that service on an ongoing basis under a licence. Such a gap will result in a poor customer experience, where customers may become attached and familiar with a product/service and then have to stop using it for an uncertain period. Both ASIC and the industry need to ensure that customers are motivated to trial new technologies, therefore ensuring they have a positive experience with products/services that prove successful and can be launched more broadly is critical.

We propose that ASIC consider providing guidance, or requiring the submission of an exit strategy prior to commencement of the testing of an innovative product/service, as to what happens at the end of the six month period if the FinTech decides not to proceed. CP260, in its present form, only contemplates that the FinTech will apply for a licence and continue operating.

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?

No, refer to A1Q1 response and the General Comments section above. The regulatory sandbox exemption should be offered to incumbent as well as new Australian businesses as this ensures a greater pool of innovation talent is being afforded the same opportunity and that consumer choice is even greater.

C1Q4 Please estimate any additional costs or savings that consumers might be expected to incur as a result of this change.

On the assumption that ASIC limits this to concept validation, then consumers should be a net beneficiary i.e. Consumers will not incur costs to be part of concept testing, but rather a greater choice of product/service offerings is ultimately created with greater speed to market.

SERVICE RESTRICTIONS

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 and how could these risks be mitigated?

There are further financial services that would benefit from an exemption of this nature and inclusion in the regulatory sandbox. As each financial service has a different category of risks and benefits, it is recommended that each additional financial service is considered through industry engagement and feedback to ensure these risks can 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?

Refer to comments in C1Q1; each extra financial service, or product type/security type should be considered through industry engagement as there are different risks for consumers and businesses depending on the asset and product class.

We propose that the exemption should cover the full breadth of financial services products including lending and payments where innovation is moving at a rapid pace.

- (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?

We note that ASIC's proposal is predominately focussed on retail clients, however wholesale clients are touched on in several areas of CP260. While acknowledging the retail/wholesale client distinction, consumer safeguards are still important irrespective of client status. We therefore recommend that ASIC provide more clarity as to their expectations with respect to innovation for wholesale clients.

EXISTING AFS LICENSEES

C3Q1 Do you agree with this proposal? Please provide reasons for your answer.

No, refer to A1Q1 response above. In order to promote competition and a level playing field, it is suggested that the relief also be made available to existing AFSLs who wish to either help an emerging FinTech business or produce emerging services itself. It should be recognised that a lot of FinTech innovation will take place via new FinTech businesses partnering with established players rather than competing against these established players. The proposal as it currently stands could restrict the ability for FinTech businesses to access the distribution networks for established players which would prevent them from availing of greater efficiency and innovation.

These changes could this impact our members' initiatives with businesses they currently work with or the innovation labs within the industry.

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?

There are issues relating to innovative services however these are many and nuanced to product type/asset class and/or the value proposition to consumers. Ones that could be dealt with on an industry wide basis would include: access to regulatory sandbox exemption to test in the same way as "new Australian businesses".

CLIENT AND EXPOSURE LIMITS

C4Q1 Are the retail client exposure limits we have identified appropriate?

The maximum exposure limit is high and, at the extreme, potentially represents a \$1 million loss with no guarantee of financial compensation. This type of risk is more appropriate to a particular type of consumer rather than a general cap on client numbers i.e. refer B4Q1 response above: education, credit rating etc. become important determinants of ways to minimise the risk of loss to an uninformed consumer.

While we recognise that unregulated services shouldn't be launched too widely, many of our members have an extensive retail customer base; as such a pilot of 100 is immaterial and they would be looking to test new innovative services on a broader base before launching to a live audience. We recommend that the limitation of 100 not be a fixed number but, rather, have sufficient flexibility to adjust for the complexity and size of the innovative product/service being tested.

C4Q2 An alternative approach would be for the exposure limit of retail 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?

A graduated approach to limit exposures would be another mechanism for minimising risk to consumers in regards to loss or negative experience. This should still be coupled with education from the business/service provider. The risk in an approach of this nature lies the additional complexity of ensuring retail customers meet the asset requirements – this would slow down progress of innovation and speed to market.

C4Q3 Are there other ways that we could facilitate innovation while limiting the risk of loss to any one individual?

Our members would typically have policies in place which cover extending Lending and Deposit facilities to such businesses. Although, they may not have controls to monitor dollar volumes limits or the ability to ensure their business is limited to 100 customers as outlined in CP260.

We recommend ASIC provide clarity as to whether Is it the responsibility of the lender to ensure that the FinTech complies.

COMPENSATION ARRANGEMENTS

C5Q1 Do you believe that testing businesses will be able to obtain professional indemnity insurance to compensate retail client losses?

Professional indemnity insurance may be difficult to get for new FinTechs. We recommend that ASIC provide guidance as to how adequate compensation arrangements will be provided in the event that a

FinTech may not be covered by professional indemnity insurance or otherwise have sufficient or adequate resources to meet any potential liabilities.

OTHER CONSUMER PROTECTIONS

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.

Yes, the conditions identified are appropriate.

C6Q2 Are there any other consumer protections that should apply to clients of testing businesses? If so, what are they?

Yes, additional tests on revenue models and ongoing viability of the business (capital backing/cashflow) would further increase protection for consumers.

SANDBOX SPONSORSHIP

C7Q1 Do you support the requirement for a testing business to be ‘sponsored’ by an industry organisation? Please give reasons for your answer.

Yes, testing businesses should be sponsored by an industry organisation. It is our suggestion that it would be prudent to include a broader definition of sponsorship than what is currently provided in the consultation paper. We would encourage ASIC to consider that these ‘sponsoring organisations’ not be limited to not-for-profits or government recognised entities; rather, it should be extended to include existing businesses who also meet the sponsoring criteria.

We would appreciate ASIC providing greater clarity regarding the types of organisations that qualify as a sponsor.

C7Q2 What types of entities should ASIC approve as sandbox sponsors?

See C7Q1 above. We would propose that an established bank could play the role of a sponsor for a start-up or new FinTech that it is partnering with. Further, it would be helpful if ASIC could provide greater detail regarding what would be the role of the sponsor. For example, does the sponsor need to provide financial support or commit full-time employee support?

We recommend ASIC provide clarity as to whether a sponsor who provides financial support is then considered a lender, thereby triggering the issues raised in C4 above.

C7Q3 How should ASIC ensure that a sandbox sponsor is only sponsoring appropriate testing businesses?

ASIC should consider criteria for sponsoring organisations such that there is a sufficient level of understanding of the importance of the sponsoring organisations role; and responsibilities to consumers, the industry, ASIC etc. in sponsoring a testing, or FinTech, business.