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22 July 2016

Mr Richard McMahon  
Acting Senior Manager  
Deposit-takers, Credit and Insurers  
Australian Securities and Investments Commission  
Level 5, 100 Market Street  
SYDNEY NSW 2000

By email InnovationHub@asic.gov.au

Dear Mr McMahon

**Submission to ASIC on Consultation Paper 260  
Further measures to facilitate innovation in financial services**

We refer to Consultation Paper 260 issued by ASIC in June 2016 regarding ASIC's proposed approach to facilitating innovation in financial services.

We welcome the opportunity to provide comments on the issues raised in the consultation paper.

Our comments on selected issues are set out below.

**Part A – Background to the proposals**

**Measures considered in this consultation paper**

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

We agree that ASIC should put in place additional measures to facilitate innovation in financial services, because maintaining the status quo means that barriers to enter the financial services market will be maintained.

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

We anticipate that the proposed approach will facilitate innovation, increase competition in the financial services market and provide more choice of products and services for consumers.

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

Some potential lessening of consumer protection.

## **Part B – Additional guidance and flexibility on organisational competence**

### **Additional guidance on assessing knowledge and skills under Option 5 of RG 105**

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

We agree with this proposal as there is currently little, if any, information available as to what kinds of scenarios are intended to be covered by Option 5 of RG 105 and ASIC's approach to submissions under Option 5 of RG 105.

We often provide advice to fintech start ups about licensing and in particular, regarding whether a proposed responsible manager's knowledge and skills are sufficient. Therefore the proposal would assist our clients.

Additional guidance on the assessment of a proposed responsible manager's knowledge and skills under Option 5 of RG 105 would also, in our experience, be useful to industry more broadly (and not only for persons establishing innovative businesses).

**Question B1Q2** Do you think the examples provided below are helpful? If not, why not?

The examples are helpful as they provide an indication as to the kinds of scenarios where ASIC may or may not accept responsible managers under Option 5 of RG 105.

**Question B1Q3** Subject to the other proposals in this paper, is there anything else you think we should cover in our updated guidance on Option 5 of RG 105?

We think it would be helpful to provide a wide range of examples. We would also recommend providing commentary as to the principles or rationale underlying such examples.

### **Additional flexibility for small-scale, heavily automated businesses**

#### **Nominating responsible managers**

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

We welcome the introduction of an additional option for heavily automated business. However, we are concerned that for small scale businesses, the cost of obtaining the proposed sign-off from a professional third party will be prohibitive.

This proposal also means that the business must have at least two responsible managers.

**Question B2Q2** What sort of professionals should ASIC accept as responsible managers that provide sign-off?

The kind of professional would depend on the kind of business involved and what exactly the sign-off needs to cover.

**Question B2Q3** Are there any other situations where this type of flexibility should be available?

This type of flexibility could also be made available to heavily automated businesses that are not small-scale.

**Question B2Q4** Are there any risks associated with this proposal? If so, what are they?

There may not be sufficient appropriately regulated and experienced professional third parties available at costs that a small scale start up business will be able to bear.

This proposal relies on the licensee advising ASIC if a significant change to the licensee's operations occurs. As ASIC has no exposure to such information, this requires the licensee to proactively update its sign-off and lodge a copy of the updated sign-off with ASIC.

**Question B2Q5** Please estimate any cost savings that a new business would expect to realise from this proposal.

The costs involved with obtaining a sign-off from a regulated and experienced professional are likely to outweigh costs savings, if any. This is particularly the case given:

- that the third party professional is expected to be accountable for the sign-offs they provide; and
- ASIC's expectation that the sign-off would be required to certify that the licensee is materially compliant with the laws ASIC administers.

Further costs may be incurred if the licensee's arrangement with a professional third party were to terminate. In that situation, the licensee would need to engage another such third party and bring them up to speed on its business.

#### **Requirements for third-party sign-off**

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

In order for this approach to be an effective option, we consider the sign-off should be limited to whether:

- the business has appropriate policies and procedures in place to enable it to comply with relevant requirements; and
- any algorithm used to generate outcomes for clients is appropriate.

We consider this to be appropriate in light of the fact that the business will have another responsible manager who is involved in the day to day running of the business.

**Question B3Q2** Is an annual sign-off appropriate?

24 months would be more appropriate, subject to sign-off for significant changes.

#### **Conditions of eligibility for third-party sign-off**

**Question 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?

As mentioned in response to Question B2Q1 above, we think that for small-scale businesses, the cost of obtaining the proposed sign-off from a professional third party will be prohibitive. Therefore a limit of 1,000 clients is not appropriate.

Limiting eligibility to licensees with a certain number of retail clients may also pose problems for the growth of that licensee's business. If the licensee's business grows to more than 1,000 retail clients in a short space of time, it may find itself having to turn away business until such time as it can identify and appoint an appropriate alternative responsible manager.

## **Part C – AFS licensing exemption for limited service testing**

### **Six months of unlicensed financial service testing with retail clients**

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

We agree with this proposal as it allows businesses to test financial products while also seeking to protect consumers.

We would welcome more detail about the proposed operation of this exemption. At the conclusion of the initial six month testing period, the business will need to apply for an AFS licence if it wishes to continue in operation. This process can take at least six months, with the result that the business would need to cease providing financial services for this period.

**Question 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?

The exemption should also apply to existing Australian businesses who would like to offer new services but whose existing businesses do not require an AFS licence. This will encourage innovation and competition. The conditions that apply could be the same.

**Question C1Q3** Please estimate any cost savings that a new business would expect to realise from this change.

A business would save the costs of obtaining a licence, which could be anywhere from \$20,000 to \$70,000. These costs would only be saved if the business did not ultimately proceed to apply for an AFS licence, for example if the business did not prove successful during that initial six month period.

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

We do not expect there to be additional costs to consumers. Additional savings are difficult to quantify but the benefits to consumers are increased choice of services in the market and increased competition.

### **Scope of exemption**

#### **Service restrictions**

**Question 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?

We consider that the scope of the proposal is appropriate.

- (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?

Simple short term foreign exchange contracts and derivatives as these would be suitable for a six-month trial by an unlicensed business and are likely to be more familiar to wholesale investors.

- (c) If you believe the exemption should be extended to less liquid or more long-term arrangements, how could any additional risk to consumers be mitigated?

Imposing appropriate compensation arrangements on the testing business.

### Existing AFS licensees

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

We agree with the proposal not to provide relief to existing AFS licensees. Existing licensees who wish to develop innovative products and services would generally be expected to have the resources and experience to do so in compliance with the existing requirements.

### Conditions of exemption

#### Client and exposure limits

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

We agree that it is appropriate to impose exposure limits for retail clients. We consider that a limit of \$10,000 will be appropriate for some retail clients, but that in some cases a lower limit may be more appropriate.

**Question 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?

We consider it could be difficult for businesses to determine a retail client's exposure limit on the basis of that client's total net assets. This is particularly the case given the limited resources of such businesses.

- (b) Would any benefits with this approach outweigh the resulting complexity for the testing business?

Depending on the extent of the inquiries that a business would need to make about each retail client's total net assets, the costs of the resulting complexity may outweigh the potential benefits of this approach.

- (c) Are there any risks with a graduated approach?

Although potentially impractical, we do not foresee any major risks with a graduated approach.

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

A government guarantee scheme for eligible startups during the six month testing phase.

### Compensation arrangements

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

We expect that the process and cost of obtaining professional indemnity insurance may make this prohibitive. However, insurers would be better placed to respond to this question.

**Question C5Q2** What other compensation arrangements could be used by testing businesses (e.g. group cover or mutual fund schemes)? What practical issues exist with other compensation arrangements?

A government guarantee scheme for eligible startups during the six month testing phase.

### Other consumer protections

**Question 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.

We think this is reasonable. The disclosure condition could be expanded to refer to the fact that because the service is being provided in a testing environment, there may be greater risks involved.

### Sandbox

#### Sponsorship Proposal

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

In principle we support this requirement as a sponsor may be an effective 'gatekeeper', provided the costs of obtaining sponsorship are not prohibitive and there is sufficient availability of suitable sandbox sponsors.

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

Entities that are suitable for the role by virtue of being sufficiently independent and possessing adequate expertise.

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

The sandbox sponsor should have no conflicts of interest and sufficient expertise to make the sponsorship decision. Sponsors should be required to have regard to general criteria, issued by ASIC, as to what constitutes an appropriate testing business.

**Question C7Q5** What costs, if any, would testing businesses incur in obtaining sponsorship?

This would depend on the responsibilities and potential exposure of the sponsor. We expect that in any case there would be a cost in obtaining sponsorship. If the sponsor is expected to be responsible for the actions of the testing business, that cost could be significant.

If businesses are expected to enter into formal agreements with sponsors, this would also involve some cost (for example, legal costs).

### **Integrity measures**

#### **Notifying ASIC**

**Question C8Q1** Do you agree with this proposal? Please give reasons for your answer.

The proposals seem reasonable as they are not onerous obligations.

#### **Withdrawal of relief**

**Question C9Q1** When should we exercise our power to withdraw the licensing exemption?

We agree that ASIC should exercise its power to withdraw the licensing exemption in the circumstances set out in the consultation paper. We consider ASIC should also be able to exercise this power when the testing business does not comply with the conditions of the exemption, or when it considers investors' funds may be at risk.

For further information or clarification about any matter in this submission, please do not hesitate to contact us.

Yours sincerely

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for **Gadens**