



Mr R McMahon
Acting Senior Manager
Deposit-takers, Credit and Insurers
Australian Securities and Investments Commission
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Sydney NSW 2000

Sent by email: InnovationHub@asic.gov.au

22 July 2016

Dear Mr McMahon

ASIC Consultation Paper 260: Further measures to facilitate innovation in financial services

PwC welcomes the opportunity to comment on ASIC's Consultation Paper 260 "*Further measures to facilitate innovation in financial services*" (CP260).

The digital revolution is transforming the way customers access financial services and products. Our clients in the financial services sector are experiencing change at an incredible rate and the industry's status quo is rapidly changing as a result of FinTech¹.

PwC Australia is supportive of ASIC's efforts to facilitate innovation within the financial services sector. It is a key step in creating a regulatory environment conducive to new ideas with the aim of creating better consumer outcomes whilst also managing the potential downside risk to consumers and Australia's financial services system.

The proposals outlined by ASIC are a positive step forward in providing early-stage FinTech companies the opportunity to validate their ideas, products and business models, whilst developing their organisational risk and compliance capabilities from "day one". The proposals give FinTechs two key benefits, time and reduced upfront costs to support their transition to full licensing when they are ready to scale up their operations in the broader market.

Additional measures to facilitate innovation will help develop the financial services sector by:

- Enhancing Australia's strong reputation in financial services
- Increasing Australia's ability to compete on a global scale (export financial services innovations and talent)
- Creating jobs, attracting talent and fostering inward capital flows

In preparing our response, we have engaged with a number of our clients and other participants in the Australian Fintech Industry as well as looking to other jurisdictions' proposed and implemented regulatory sandbox models.

¹ Blurred Lines: How Fintech is shaping Financial Services. PwC Global Fintech Report March 2016.
www.pwc.com/fintechreport



Just as Fintech companies adopt an agile approach, we believe ASIC's proposed framework will also need to be flexible. ASIC and other regulators will need to keep pace with the financial services industry's future needs in order to maintain relevance and build trust in the community when new technologies, products and innovations are rewriting the business landscape.

We welcome the opportunity to discuss our response with you and share our insights from our discussions and interactions with clients and other industry participants.

Yours sincerely

A handwritten signature in black ink that reads 'J Coates'.

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Appendix – PwC’s views on ASIC’s CP260 proposals

ASIC proposal

A1 We are considering the options set out in paragraph 31. Our preferred option is Option 4 (i.e. a combination of Options 1–3).

In this proposal, we are seeking your general feedback on our approach to further facilitating innovation in financial services.

We are consulting in more detail on particular aspects of our proposals in Sections B and C.

PwC views

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

Yes, we agree ASIC should implement additional measures to facilitate innovation in the existing regulatory system with a combination of Options 1-3. We believe ASIC’s proposals, such as the opt-in regulatory sandbox exemption for early stage FinTechs, is forward thinking in comparison to proposals in other jurisdictions that favour a one-by-one application approach.

In our experience, innovation within the financial services sector has generated ground breaking products and services that continue to be relevant today. For example, the invention of the credit card in the early 1950’s continues to play a significant role in the way consumers and businesses pay for products and services. Advances in technology and innovation, such as real time credit checks, fraud prevention and payment instruction execution, have allowed credit card products to continue to evolve and remain relevant to consumers in an increasingly digital society. Cryptocurrencies and blockchain technology are more recent breakthroughs that continue to be explored for their innovation potential.

Continued innovation fosters a healthy financial services industry and broader economy. Innovation often brings greater convenience and choice to consumers in the relentless pursuit by businesses to better meet changing consumer preferences.

In a technologically enabled age, innovation is high on Australia’s agenda². It is critical that our nation’s regulatory framework keeps pace with the changing financial services landscape to ensure innovation is encouraged and the related risks are managed. Ensuring the right balance between reaping the benefits and minimising the downside risks will ensure both regulators and organisations continue to promote trust, confidence and integrity in the capital markets framework.

Based on our discussions with industry participants, ensuring regulators strike the right balance is the most common area of concern raised. In particular, the upfront time and cost of licensing and regulatory compliance was cited as a potential barrier to market entry and an inhibitor to progressing ideas and securing capital. The measures that ASIC has proposed in CP260 were welcomed by many of the industry participants we engaged with, although some suggested that

² Source: <http://fintech.treasury.gov.au/>, accessed 12 July 2016.



ASIC extend their proposal to provide greater access for innovators whilst appropriately managing the risks.

For example, ASIC could expand the types of financial services and products to which the sandbox exemption applies. Superannuation and insurance were two specific sectors where FinTechs could play a role in helping to drive innovation. Similarly, the new ideas and innovations within the FinTech industry may have broader application to other businesses outside of the financial services industry (for example, working capital solutions for small businesses).

The nature of startup organisations is that they are flexible and change focus often based on new knowledge and experience in their markets, this is known as a “pivot”. We believe that ASIC will need to adopt a similar level of flexibility in implementing these proposals. We encourage ASIC to attentively observe performance, proactively gather feedback from the first adopters of the proposals and keep an eye on how the FinTech industry develops further, to ensure this information shapes future iterations of the proposals so that they continue to be fit-for-purpose.

There are also risks with innovation and these need to be managed to ensure positive consumer outcomes and stability in the financial services system are maintained. We recognise that in some cases some organisations may not have the breadth and depth of expertise when compared to other more mature businesses. Building this capability, and in particular, ensuring readiness before transitioning to full licensing, is critical to the future success of these organisation and the industry as a whole. ASIC may wish to develop benchmark competencies during the testing period, as well as ongoing support through ASIC’s innovation hub³ with an incentive of receiving a faster track to licensing. We believe that in doing so, the industry will place equal importance from inception on customer outcomes and risk management as to developing and growing their business.

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

We expect many benefits to flow from ASIC’s proposed approach.

At a micro-economic level, start up enterprises will find it easier to understand and meet ASIC’s licensing processes; new market entrants will be less daunted by the complexity of the system and overall it will make it easier to do business in Australia.

At a macroeconomic level, it may mean that Australian based start-ups find they are quicker to market and our FinTech regulatory framework remains competitive with other jurisdictions. This is particularly important as FinTechs look to expand their platforms globally to achieve scale.

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

With innovation comes failure. We understand from the proposals that certain measures, such as the sponsorship requirement as part of proposal C7, will be implemented to mitigate risk. In our view, we have three key areas of concern:

1. The “opt-in” exemption model is hinged on having appropriate and sufficiently independent sponsoring organisations conducting the initial due diligence

³ Source: <http://asic.gov.au/for-business/your-business/innovation-hub/>, accessed 21 July 2016.



2. The proposed regulatory sandbox approach does not appear to proactively identify risks throughout the testing period
3. More can be done on building the organisational competency and transition to full licensing during the period of adoption of the small-scale heavily automated and sandbox exemptions
4. As the Australian FinTech industry continues to grow, we have some concerns with the number of potential participants that could act as independent sponsors under the proposals. We also believe that a key element of the sponsorship approach would be to have both sufficient experience to assess organisations but also a level of independence from them to be able to play an objective role. For example, if a sponsor were also an investor for the same organisation, this could create a potential conflict of interest which we believe is not aligned to the intent of the proposals.

We believe a proactive monitoring approach combined with well-defined boundaries of operation of the sandbox will ensure downside risks are minimised through the testing period without hindering the innovation capacity of businesses.

For example, a simple and quick progress 'health check' between ASIC and a regulatory sandbox participant would allow ASIC to identify potential failures early, and take proactive, preventative action to ensure that any impact on customers is minimised.

The form of the progress 'health check' could be as simple as responding to a verbal question list designed to be quick and easy to perform but also comprehensive enough for ASIC to identify any emerging risks that may warrant further discussion. The questions could cover items such as:

- Has the original concept or business model changed?
- Has the testing plan changed?
- Have new risks been identified? If so, what has been put in place to mitigate these risks?
- Have any issues been identified in testing with retail/wholesale consumers?
- Do you continue to be in good financial standing to continue to operate for the test period?
- Are you making progress on developing the capability to move to full scale licensing at the completion of the test period?

We recommend that further clarity be given that the proposals are only interim measures that allow FinTechs to validate their idea and test their product and alongside this, the organisation is building the necessary organisational competencies to become fully compliant to move to being fully licensed and in situations where FinTechs are ready, a faster path to licensing. We recommend that further consideration be given to transitional measures when FinTechs come to the end of the sandbox period or no longer meet the small-scale heavily automated definition. We believe that in some situations, more time may be needed to transition to full licensing, without unduly impact the ongoing business.

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?

We believe there is growing innovation in non-cash payment facilities and for credit licensing. Often these licenses are required to be held in addition to holding an AFSL.



We recognise that separate regulatory guidance and licensing regimes exist for these two areas^{4,5}. However, we encourage ASIC to consider extending the concept of the regulatory sandbox exemption to these licensing regimes to further help facilitate innovation. Further, where new innovations within the payments sector begin to emerge, licensing may require the organisation to apply for status under APRA regulation as a purchased payment facility⁶.

Where we believe licensing overlaps between multiple regulatory bodies, adequate support and linkage between the regulatory requirements should be provided to facilitate innovation.

ASIC proposal

B1 We propose to provide additional guidance on how we assess submissions about a responsible manager's knowledge and skills under Option 5 of RG 105. This will include:

- a) more detail about what we expect a prospective AFS licensee to include in its submission; and
- b) examples of situations where we generally would (or would not) consider that a responsible manager has the appropriate knowledge and skills (see Example 1 to Example 4 below).

Note: We are not proposing to change how we assess submissions under Option 5 of RG 105 in this proposal.

PwC's views

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

We agree with the proposal set out in B1.

The financial services industry is heavily regulated and much of that guidance is subject to interpretation. We encourage ASIC to provide more detail on its expectations about the items that should be included in a prospective licensee's application. This would help:

- improve the quality of applications being submitted
- businesses identify any organisational competence gaps and address them prior to submitting the application
- guide a startup to ensure it hires key staff or seeks co-founders to act as responsible managers (RMs) to fill specific areas where organisation competencies are needed

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

Yes, we consider the examples to be helpful, particularly by clarifying situations where an application under option 5 would likely be accepted and where applications would likely not be accepted. However, we recommend ASIC enhance the clarity of certain examples.

⁴ Regulatory Guide 185 *Non-cash payment facilities*

⁵ Regulatory Guide 204 *Applying for and varying a credit license*

⁶ Source: http://www.apra.gov.au/adi/Documents/ADI_GL_Providers_of_Purchased_Payment_Facilities.pdf, accessed 19 July 2016



Example 2:

Although not strictly relating to option 5, RM1 is described as having met option 3 despite not meeting the experience requirements (fewer than 3 years in dealing and advising). However, we consider that this part of the example illustrates a very important point on organisational competence, particularly in relation to the technological aspect of the organisation in the context of FinTech.

In our view, the technological aspect of FinTech is of equal significance to relevant financial knowledge and advising/dealing experience. Understanding how the technology works (for example, an algorithm in a robo-advice organisation) is important to organisation competence so that any automated element is understood both at inception and on an ongoing basis, to ensure fair customer outcomes and promote trust and transparency.

We believe that further clarification be given on situations where RMs are from other jurisdiction, such as that of RM2, and how they are able to meet the requirements. We expect that as part of the broader Australian innovation agenda⁷, there will be more participants in the industry seeking to be RMs, who have overseas qualifications and experience.

Example 3:

In the final comment outlining the rationale that the RM's experience does not relate to the provision of advice and issue of securities associated with marketplace lending, we believe that there may not be many people in the industry with specific market-place lending experience. We believe that currently and as technology and ideas continue to evolve, there are similar situations where there may not be a high availability of certain skill sets in specific areas.

Further clarity could be given as to the specific rationale behind declining this RM. For example, more specific experience was required in advising and issues of securities wholesale clients.

Examples 3 and 4:

Should proposal B2 be implemented, notwithstanding our views on the proposal, we believe the examples should indicate the link to using a third-party RM in order to meet the requirements.

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?

No further comment.

⁷ Source: <http://www.innovation.gov.au/page/supporting-innovation-through-visas>, accessed 21 July 2016



ASIC proposal

B2 We propose to amend RG 105 so that a small-scale, heavily automated business would be able to meet its organisational competence obligation by nominating responsible managers in the following two categories:

- a) responsible managers (as currently defined in RG 105) that have knowledge and skills that are relevant to some, but not all, aspects of the financial services the business will provide; and
- b) an appropriately regulated and experienced professional third party that will provide sign-off for the remaining aspects of the business's financial services.

To rely on B2, we propose that businesses will also need to meet the terms set out in proposals B3 and B4.

PwC's views

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

We agree with proposal B2 as an interim measure that FinTechs can adopt until the organisational competence and capabilities are built within the organisation, or where they no longer meet the definitions of a small-scale, heavily automated business.

We recommend that the proposal be enhanced to deal with two key areas where we believe FinTechs face issues in meeting organisational competency requirements:

1. The organisation has competence in many aspects required by their AFS license but not all aspects
2. The skillset required to meet the organisational competence requirements are very specific, requiring a specific subject matter expert in a particular area that cannot be sourced from within the organisation (for example, managed discretionary account experience)

We believe that alongside this, guidance should be provided to the organisation to assist in developing the required competencies, whether by the third-party or through the ASIC innovation hub, such that when the business no longer meets the small-scale or heavily automated definition, it can transition to the full licensing regime without interruption to the business.

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

We believe there are two types of professionals that could be accepted as third-party RMs that could provide sign-off:

1. A professional who holds an AFS License with similar license conditions to that of organisation they will provide the sign-off. This will ensure they third-party has sufficient understanding of the requirements (including compliance, documentation and the audit process) and their role in helping the organisation close their internal competency 'gaps'
2. Subject matter experts who have the specific experience and knowledge in a particular area where the organisation needs to fill that competency.



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

In our view, the flexibility proposed should be expanded and not limited just those that meet the small-scale, heavily automated business criteria.

There is a perception that these types businesses are lower risk due to the intense focus on developing the automated technology at the inception of the business. We believe that small heavily automated businesses often have ongoing risk in operating their platform, particularly if the knowledge supporting the design and operation of technology underpinning the business model, leaves the organisation. Therefore, these organisations can carry equal risk to businesses that do not meet this definition.

With respect to our comments in B2Q1 and B2Q2 on the situations FinTechs come across with regard to organisational competence and the types of third-parties that could help with this, we believe this flexibility should be offered to a broader set of companies outside the small-scale, heavily automated business definition.

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

We are aware that the potential cost of engaging a third-party could be prohibitive to many start-up organisations. Linked to this, there is a risk that the sign off could become a commoditised service.

The risk of commoditising the service could be reduced if ASIC was prepared to only accept recognised organisations or individuals that can provide the third party sign-off. An example of this is outlined in our view in B2Q2 where existing AFS licensees could act in this role where they are aware of the AFS requirements and conscious of risk and liability.

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

No comment.

ASIC proposal

B3 We propose that a professional third-party responsible manager providing sign-off under proposal B2 would be required to examine all the relevant material and certify that the AFS licensee is materially compliant with ASIC-administered legislation.

We propose that:

- a) sign-off would be required every 12 months, or on significant changes to the AFS licensee's operations
- b) the AFS licensee would need to lodge a copy of the sign-off with ASIC. Responsible managers who provide a sign-off that contains false or misleading statements may commit an offence under s1308 of the Corporations Act.



PwC's views

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

We agree with ASIC's rationale that the sign-off should follow the requirements of s601HG(3) and s989B of the Corporations Act 2001.

In addition, we believe an attestation from the organisation that the third party has been appropriately involved and an agreement that the third-party has performed their responsibilities should also be provided.

We also propose that clarity be given on what "materially compliant" means in practice as this currently is not a concept within current AFSL regulations and is open to interpretation by different third-party responsible managers.

B3Q2 Is an annual sign-off appropriate?

Yes, but we encourage ASIC to also consider a semi-annual "check in" to take place between the licensee and the third-party responsible manager. This would help the third-party responsible manager identify if there has been any significant change in the business that would impact the license.

We believe this is important given the continuously evolving nature startups adopt through their lifecycle. This could be in verbal form, similar to the example outlined in our view in A1Q3. The results of these inquiries would result in a notification to ASIC in the event of a reportable change.

We also recommend that a self-identification process is implemented. This would require licensees to notify both ASIC and their third-party responsible manager in the event of a material change in operations or a breach.

ASIC proposal

B4 We propose that proposal B2 will only apply to AFS licensees that:

- a) provide financial services to no more than 1,000 retail clients
- b) only give advice on, or arrange for another person to deal in, liquid financial products, non-cash payment facilities, and products issued by a prudentially regulated business.

PwC's views

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 believe there is further work to be done on defining the limits, especially if the flexibility be opened to other businesses outside of the small-scale, heavily automated definition.

In our view, these proposals should be aimed at early stage FinTechs intending to validate their business model whilst building longer term internal organisational capabilities.



Regardless of the final limits adopted, we recommend ASIC should continue to monitor this as the framework is put into practice.

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

Refer B 4Q1

ASIC proposal

C1 We propose to give conditional, industry-wide relief to allow new Australian businesses to test certain financial services for one period of six months without needing to obtain an AFS licence. We refer to this as the ‘regulatory sandbox exemption’.

We propose to place the restrictions and conditions outlined in proposals C2–C9 on the licensing exemption to ensure that:

- a) the risk of poor consumer outcomes is minimised
- b) activities carried out under the exemption are limited to early-stage testing (i.e. concept validation).

We will continue to consider requests for an individual exemption by businesses that do not meet the terms of the industry-wide relief.

PwC’s views

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

Yes, we agree with proposal C1.

There has been a lot of international development in this space, with several other jurisdictions having implemented or proposed similar approaches. At a conceptual level, we consider that introducing the regulatory sandbox exemption would better position early stage Australian FinTech companies in the following ways:

- Ability to test their product in a controlled environment reducing the barrier to entry in respect of the risk, cost and effort, in having full licensing compliance prior to testing
- Time within the sandbox to allow the FinTech to adjust the product and business model to deliver the best customer outcome
- Potentially improve access to finance with a clearer path to regulatory compliance and a business model that has been tested
- Provide FinTechs with time to better understand what licensing and organisational competence they will need before large-scale release and transition for full licensing and compliance

We do, however, have some observations in regard to managing the risks, which we will elaborate on further in proposals C2-C9.



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?

We agree with the proposal. Licensees that are large corporations will usually have the resources and experience already to meet the organisational competence requirements within the organisation. Large organisations that already have an AFS license will still be able to apply for a license variation should their existing license not cater for a new idea or innovation.

In our discussions with industry participants, including some of which have only been recently licensed, the majority were supportive of restricting the sandbox exemption to new Australian businesses only.

In our view, the term “new Australian business” is open to some interpretation. For example, if a large overseas based FinTech incorporated a new Australian company with a view to expand their product in Australia, this could be considered to be a new Australian business the current definition, allowing such companies to reduce their upfront costs and increase competition. This concern could be addressed from adding an assessment in the application process outlined in proposal C8, whereby only new innovations would be permitted to apply the exemption.

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

Broadly we expect that the introduction of the regulatory sandbox exemption would allow businesses to avoid the upfront cost of licensing and compliance. For example, in our experience, a small AFSL audit could cost between \$7,500 - \$15,000, which represents an immediate upfront saving.

In the longer term, once a FinTech reaches the end of the sandbox time limit and proceeds to larger-scale launch and full licensing, these costs will still need to be borne and for those that don't continue, the costs avoided. Therefore, in our view, the sandbox exemption is beneficial in that it delays the initial upfront costs.

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

In our opinion, there is not likely to be an immediate cost benefit or saving to customers. As noted in our response to C1Q3 above, should a FinTech launch post the sandbox exemption period, the licensing and compliance costs will need to be incurred and thus form part of the company's cost base, and ultimately built into the pricing of the product.



The savings benefits that we consider may arise:

- Potential for increase in choice for consumers which will drive increased competition and potentially lower product pricing
- there may be tangible savings from fully digital platforms that can lower operating costs when compared to traditional operating models (e.g. robo-advice), where those savings can be passed to consumers through lower product pricing

ASIC proposal

C2 We propose that the industry-wide AFS licensing exemption should only apply to:

- a) giving financial advice in relation to listed or quoted Australian securities, simple managed investment schemes and deposit products; or
- b) arranging for other persons to deal in the products in C2(a).

We will continue to consider requests for an individual exemption by businesses using a different business model.

PwC's views

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?

The consultation papers for similar Sandbox proposals from the Monetary Authority of Singapore⁸ and the Abu Dhabi Global Market⁹, have not specifically outlined in their proposals any restrictions on specific financial services.

The two areas of advice and arranging would generally capture most FinTechs, however as business models evolve and new ideas come to the market, there may be a need to have a broader exemption to cover other financial services¹⁰:

- operating a more complex registered scheme (such as those that manage a marketplace lending platform)
- providing a custodial or depository service (for example within the asset management or real estate industries)

We would expect that if the exemption was broader, similar types of restrictions to those as part of proposal C1 would apply.

⁸ Source: http://www.adgm.com/media/70182/adgm-consult-paper-no-2-of-2016_reg-framework-for-fintech-final.pdf, accessed 7 July 2016

⁹ Source: <http://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/Consultation%20Paper%20on%20FinTech%20Regulatory%20Sandbox%20Guidelines.pdf>, accessed 7 July 2016

¹⁰Source: <http://asic.gov.au/for-finance-professionals/afs-licensees/do-you-need-an-afs-licence/>, accessed 13 July 2016



We also recommend that further consideration on risks and in particular exit strategies, where a product is issued to a retail or wholesale client, needs to be articulated before the commencement of the exemption period. This would help to ensure that fair customer outcomes and stability in the broader financial services system are maintained.

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?

No, at this stage we agree with the proposed restrictions, recognising that ASIC intends to consider requests for individual exemption for businesses using a different model.

We believe the proposed restrictions on the types of financial services and products that can be offered have been made with regard to consumers being more easily able to liquidate their position in the event of an issue, compared to other longer term or less liquid products (such as insurance, lending and superannuation products).

However, in our view, as the sandbox proposal matures with further experience and feedback, there may be opportunities for ASIC to expand the types of financial services and products that would be able to apply the exemption.

For example, we believe there are opportunities in the insurance space for FinTech to create efficiencies for large insurance organisations and help create more personalised insurance solutions¹¹. Australian companies developing solutions in this space could benefit from the exemption.

We would expect that if the exemption was broader, similar types of restrictions to those as part of proposal C1 would apply, though further consideration may need to be given to the specific types of products and services that would be offered. For example, on longer term products like insurance contracts, the risks of failure and the ongoing obligation to customers' needs to be considered and appropriately managed.

(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?

No, not at this point in time.

¹¹ PwC Opportunities await: How InsurTech is reshaping insurance, June 2016



(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?

We do not believe the exemption should be extended at this point in time but we encourage ASIC to keep an open mind as the framework is implemented and with more experience. Refer to our comment on less liquid and more long-term arrangements in C2Q2(a).

ASIC proposal

C3 We do not propose to provide industry-wide relief to existing AFS licensees. We will continue to consider requests for relief by existing licensees on a case-by-case basis.

PwC's views

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

We agree with this proposal. In our discussions with industry participants, a key observation consistently raised has been that the incremental cost of innovation to existing licensees is likely to be far less, given that items such as compliance frameworks would be in place and access to capital would be easier.

We do recognise in the proposal that the option will be retained for existing licensees to apply for relief and we consider this to be a reasonable approach, as we would expect that existing licensees would be able to meet the majority of the licensing requirements and only need relief on an exception basis.

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?

No comment.

ASIC proposal

C4 We propose that the AFS licensing exemption in proposal C1 should only apply where the testing business:

- a) provides services to no more than 100 retail clients, each with a maximum exposure limit of \$10,000; and
- b) ensures the total exposure of all clients (wholesale and retail) is less than \$5 million.

PwC's views

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

Yes. We recognise it is difficult to determine thresholds, our feedback suggests that the proposed limits appear reasonable for early stage start ups. We recommend however, that these continue to be monitored with further experience and feedback as the sandbox is implemented.

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 do not believe this would be easier to implement overall. In this scenario with a graduated limited, the onus would be on the organisation to measure a client's total net assets to ensure it would apply the right exposure limit.

For some organisations this may be easy to implement and result in a better real word test if this is the intended operating model of the organisation. However, for other organisations a blanket limit approach would be easier to implement and monitor.

In our view, the sandbox exemption is aimed at helping FinTechs validate their ideas. With this in mind, we consider the additional complexity and resulting compliance monitoring outweigh the benefits and the feedback we received preferred a standardised and simple approach.

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

For innovations that target sophisticated investors, a graduate approach may allow an organisation to test its concept in a more realistic scenario.

For example, a wealth management product that is designed to target high net worth individuals may not attract many participants or yield a realistic test result, if an unrealistically low exposure limit is imposed. We would consider that a risk based approach be taken; similar to what would happen in an existing licensed organisation. This could result in a positive risk management outcome, whereby new businesses thinking along similar risk principles from the start of the company, similar to that of those established companies.

However, at this stage we believe that the benefits of this approach do not outweigh additional complexity and we prefer the standardised limits.

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

Yes, a graduated approach that would lead to an increase in exposure limit naturally brings with it increased risk. We see three key risks associated with the approach:

1. Greater complexity in rules, which requires more advanced monitoring processes in place to ensure compliance
2. Onus on the organisation to validate basis upon which graduate limit is granted (e.g. validated a client's net asset position), which may be timely or costly
3. Added complexity in monitoring by ASIC to ensure graduated limits are maintained, whereas blanket approach is conceptually simpler.

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



The Financial Conduct Authority (FCA) in the UK has proposed the idea of developing a “virtual sandbox¹²”, whereby firms to test their ideas in a closed environment using real world data. Working in an offline environment means there are no end consumers that could be impacted. We consider this to be a possible alternative for further consideration.

ASIC proposal

C5 We propose that the AFS licensing exemption in proposal C1 should only apply if the testing business maintains adequate compensation arrangements

PwC's views

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

Yes, from our discussions with industry participants we have noted that obtaining professional indemnity insurance has not posed any significant problems.

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?

No comment.

ASIC proposal

C6 We propose that the AFS licensing exemption in proposal C1 will apply only if the testing business:

- a) is a member of an ASIC-approved external dispute resolution scheme;
- b) complies with the modified disclosure requirements; and
- c) complies with the best interests duty and conflicted remuneration provisions as if the business were an AFS licensee.

PwC's views

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 agree with proposal C6.

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

¹²Source: <https://www.fca.org.uk/news/regulatory-sandbox>, accessed 21 July 2016



In addition, as noted in our response to C5Q2, we consider that the mandatory disclosure requirements should go beyond those of the Financial Services Guide, and specifically relate to the organisation operating under the regulatory sandbox exemption. We would recommend that this disclosure includes:

- A clear, plain English statement that the company is adopting the regulatory sandbox exemption
- A clear outline of the implications to the client of doing business with an organisation operating under the regulatory sandbox exemption (e.g. do consumers have the same rights under the legal framework to that of a company not adopting the sandbox exemption)
- A clear outline of the exit strategy should the FinTech not continue past the six month time period
- A clear outline of protections consumers have in the event of a problem and the avenues they can use to in the event of a dispute

These disclosures would then require customer acceptance.

ASIC proposal

C7 We propose that the AFS licensing exemption in proposal C1 will apply only if the testing business is 'sponsored' by an organisation ('sandbox sponsor') recognised by ASIC.

We propose that sandbox sponsors will be not-for-profit industry associations or other Government-recognised entities. The ASIC approved sponsors would be named in the licensing exemption (and could be updated from time to time).

We expect sandbox sponsors to only sponsor testing businesses if:

- a) that business is operated by fit and proper persons; and
- b) they have conducted a preliminary assessment that the testing business' proposed business model is reasonably sound and does not present significant risks of consumer detriment.

PwC's views

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

We agree with the proposal as we recognise ASIC's intention to provide broad platform for companies to access the sandbox, whilst managing risk within the sandbox parameters.

We believe there is a need for independence between the interests of sponsors and the testing business. For example, we consider where an Early Stage Venture Capital Fund ESVCF is investing in a testing business and is also a sponsor, this could lead to potential conflicts of interest.

The approach outlined in proposal C1 would shift the application and assessment part of the process to the sponsoring organisations, meaning there would be a greater onus on these organisations to be appropriately assessing organisations that could adopt the exemption.



With the Australian FinTech industry continuing to grow and develop, we believe there is a need for greater depth of skills in organisations that could act in the role of an independent sponsor. There is a risk that the sponsorship role could become commoditised, though we expect that sponsoring organisations will bear some liability risk in their role and this would be expected to deter this behaviour.

In looking to other jurisdictions (e.g. Monetary Authority of Singapore, Abu Dhabi Global Market, and the Financial Conduct Authority in the UK) the approach has been a one-on-one application model directly between the regulator and testing business. This approach gives direct oversight and control from a regulatory risk perspective.

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

Proposal C7 outlines that non-profit industry organisations, such as FinTech hubs and co-working spaces, or other government-recognised entities, such as Early Stage Venture Capital Funds (ESVCLPs), could act in the role of sandbox sponsors.

As noted in our response to C7Q1, we have some concerns over this model. However, should the sponsorship model be adopted we agree that such organisations could act as a sandbox sponsor. Below we set out, in our view, some of the key benefits and drawbacks of these organisations:

We see benefits of these organisations being:

- These organisations play a critical role in acting as a voice for the broader FinTech community and also in fostering and develop FinTech startup companies
- They are well connected into the industry and understand the issues that FinTech companies face
- They are represented by experienced professionals who understand the financial services industry.
- Many of the ESVCLP and other venture funds have applications and due diligence processes in place before accepting FinTechs into their programs or before investing. This level of due diligence would be similar to that, if not more rigorous than, set out in proposal C7.

Our concerns in respect of these organisations:

- The depth of capabilities in the broader FinTech industry is limited and we would consider there should be greater independence between sponsors and those that invest in or advocate FinTechs
- Ability of non-FinTech focused organisations, hubs or co-working spaces to have the depth of financial services experience and knowledge to apply sufficient level of rigour in assessing a Sandbox application
- Size and scale of their operations to be able to apply an appropriate amount of due diligence that would ensure the best outcomes for consumers, the financial system and the FinTech itself
- Managing risk and reputation of the sponsoring organisations, including considerations of their liability and any compensation they may need to pay in the event that a FinTech fails
- Ease of regulatory oversight with sufficient rigour to ensure the sponsoring organisations are acting in best interests of consumers, the financial system and the FinTech itself

- A risk that the sponsoring service could become monetised and commoditised leading to inappropriate outcomes
- Currently, the number of not-for-profit FinTech focussed industry organisations and FinTech ESVCLP are limited and all are based within Sydney, which could create a practical restriction on who could easily access these organisations if based in other regions

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

We would recommend that the oversight of sponsors from ASIC would follow the following process:

On-boarding:

- The roles and responsibilities of the sponsor should be clearly defined, including any recourse ASIC expects to have to the sponsoring organisation, if any, in the event of an issue with the sponsored FinTech
- Sponsoring organisations should make a formal submission to ASIC following a prescribed application format, being able to demonstrate competency and capability in assessing FinTech applicants. Examples would include, level of financial services knowledge and experience of Sponsor assessor's, attestation of the ability of the sponsoring organisation to support the FinTechs and how many it could appropriately sponsor whilst maintaining sufficient oversight

Oversight:

We would expect that ongoing oversight be undertaken by ASIC on sponsoring organisations to ensure they are sponsoring appropriate testing businesses. This could be performed via:

- Regular updates/dialogues with sponsors on their assessments made on testing businesses
- Retrospective review of testing business outcomes to the original sponsoring organisation assessment

C7Q4: What circumstances should a sandbox sponsor take into account when sponsoring a testing business so that the business can rely on the licensing exemption?

We consider that the types of questions outlined in application forms presented by the FCA's sandbox¹³ and the Monetary Authority of Singapore's sandbox proposal¹⁴ are an appropriate base. In short the areas we consider key to cover are:

- Background of the company, its structure, key employees and their experience
- Description of the FinTech solution, including its benefits
- Outline as to why the sandbox exemption is needed (as opposed to offline laboratory testing)
- Assessment of the readiness to test the product in the Australian market and longer-term strategy for release on a broader scale
- Financial standing of the company and ability to continue to operate

¹³ Source: <http://www.fca.org.uk/your-fca/documents/forms/regulatory-sandbox-application-form>, accessed: 14 July 2016

¹⁴ Ibid, footnote 5



- Proposed testing plan including, assessment of target consumer, risk assessment of maximum potential loss, a risk mitigation plan, defined key milestones,
- Governance and control structures in place to manage risk and ensure sandbox conditions are not breached
- Exit/transition plan in the event that the FinTech has to be discontinued or progresses to larger scale release

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

We would expect that sponsors need to cover their costs in relation to the time that assessors spend in reviewing FinTech applications.

ASIC proposal

C8 We propose that a testing business will need to:

- a) notify ASIC that it intends to rely on the AFS licensing exemption in proposal C1 from a specified date;
- b) provide evidence of sponsorship from a sandbox sponsor (see proposal C7); and
- c) declare that it has reasonable grounds to expect that it can operate its business for a period of six months from the specified date.

We also propose to require that testing businesses give us a short report about their test following completion of the testing period.

PwC's views

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

As outlined in C7Q1, our preferred approach would be a case-by-case application basis directly with ASIC, as this gives direct oversight of the suitability and readiness of applicants in adopting the exemption.

However, we do recognise the benefits of having an opt-in exemption platform which has the potential benefit of speeding up the time to market for the types of financial services and financial products permissible. In adopting the sponsorship approach, we agree with the items outlined in proposal C8.

We also recommend that there is ongoing oversight, whether by ASIC or the sponsoring organisation, to assist in proactive identification of any problems arising before the end of the testing period. This could be performed by asking a small number of questions in a monthly verbal update between ASIC and the testing business, similar to that recommended in our view on B3Q2.



ASIC proposal

C9 We propose that ASIC will have the power to withdraw the AFS licensing exemption in proposal C1.

PwC's views

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

As noted in our response in A1Q3, we consider that a proactive monitoring and engagement approach with ASIC and the organisation would identify poor outcomes in a timely manner, which may then warrant revoking the licensing exemption. Such instances could include:

- Identified breach, whether self-identified or otherwise, of the regulatory sandbox operating conditions
- Adverse consumer or financial services system impact identified, whether self-identified or otherwise.