

2 August 2016

By Email: InnovationHub@asic.gov.au

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

Dear Richard

Further measures to facilitate innovation in financial services

Squire Patton Boggs (AU) and Hemisphere Legal welcome the opportunity to make a joint submission in relation to *Consultation Paper 260: Further measures to facilitate innovation in financial services (Consultation Paper)*, released for comment on 8 June 2016.

About Squire Patton Boggs (AU)

Squire Patton Boggs is one of the world's strongest integrated law firms, with more than 1,500 lawyers in 45 offices across 21 countries.

Squire Patton Boggs advises a diverse mix of clients (from long-established ASX200, FTSE 100 and Fortune 500 corporations to emerging businesses, start-up visionaries and sovereign nations) across multiple practice areas and industries.

About Hemisphere Legal

Hemisphere Legal is an Australian incorporated legal practice that assists new entrants and start-ups to navigate Australian financial services and credit regulation. Hemisphere Legal offers specialist advice on all aspects of Australian Financial Services Licences (**AFSLs**) and Australian Credit Licences (**ACLs**), assists with dispute resolution and provides comprehensive compliance training for holders of AFSLs and ACLs.

Based at Stone & Chalk in Sydney, Hemisphere Legal experiences first-hand the impact of Australia's financial services and credit licensing regime on new entrants and start-ups in the FinTech space.

Summary of Submission

- (a) We agree that the proposal to permit a professional third-party to sign-off on certain aspects of a FinTech's AFSL, where the FinTech's responsible manager is not authorised for those aspects, has merit. However, there are a number of issues that need to be addressed for this proposal to be effective, including issues of scope/criteria for the provision of this professional service and cost, as well as guidance for FinTech companies as to the management of confidentiality and conflicts.

(b) We agree with the creation of a regulatory sandbox. However, we consider that:

- the duration of the sandbox period for a start-up FinTech company should be 9 -12 months rather than 6 months, with an appropriate arrangement for extension in order to cover the time between applying and being granted an AFSL;
- relief should not be limited to one iteration of a product or service;
- relief should be available to existing AFSL holders (where such AFSL holders do not have the particular authorisation required for the FinTech product or service);
- the regulatory sandbox should not be limited to Australian businesses (i.e. locally incorporated companies) only and should extend to foreign companies registered with ASIC from jurisdictions with which we currently have pass-porting arrangements (and who have been accepted by ASIC under the pass-porting regime);
- the maximum exposure limit for retail clients should be between \$25,000 - \$30,000;
- there should be adequate consumer protection disclaimers in place (and we suggest this could be in the form of a standardised template risk matrix, which all companies in the regulatory sandbox must complete disclosing risks in accordance with a list of criteria);
- the products and services that are eligible for the sandbox should be extended to include credit products, and further clarification should be provided on managed investments scheme products; and
- more clarification should be provided on the role of a sponsor.

Additional Explanation

(a) Nominating Responsible Managers (Proposal B2 and B3)

We agree with this proposal in principle, but we consider:

- a blanket exemption could apply to a start-up FinTech company which has an AFSL from requiring relevant authorisations under its AFSL (i.e. those authorisations which the FinTech company does not have but which are applicable to a particular product or service) for the applicable 9-12 month period in the regulatory sandbox where such company already has a responsible manager and is familiar with the licensing regime and its compliance requirements, rather than requiring a third-party sign off, with such FinTech company then being required to put in place a responsible manager with the relevant competencies after the 9-12 month sandbox period

and vary its AFSL accordingly (see our further comments in paragraph (b) below); or

- if the proposal proceeds with requiring a third-party sign off in respect of certain authorisations for which the FinTech company does not have a responsible manager nominated, then we recommend that:
 - As the cost of varying an AFSL is generally between \$6,000 - \$10,000 (the majority of this cost in each instance comprises legal fees) and the cost of hiring a responsible manager can be between \$40,000 to \$70,000 per annum (depending on their role), which are typically prohibitive costs for a FinTech company, we would wish to ensure that the costs which a third party professional may charge for providing a sign off would be in a range that would not be a prohibitive cost for FinTech companies. It may be useful for ASIC to work with industry to give some guidelines as to what an appropriate range of fees would be for providing this third party sign-off function.
 - The relevant third party providing the sign-off should demonstrate:
 - That they understand the licencing regime either by being a person or entity which has an AFSL; or is a responsible manager who has been a responsible manager for at least 2 years; or is an authorised representative of an AFSL holder for at least 2 years; and
 - knowledge and experience in the particular technological application which provides the financial service or product for which they are being asked to provide the sign-off, by:
 - demonstrating technical qualifications attained through a relevant education course; and
 - providing a short table of technical competence in a similar format to a table of organisational competence; and
 - providing two business references from persons in the industry in a standardised format (similar to how responsible managers demonstrate their competency).
 - ASIC should keep a register of third party professionals who can provide the required sign-offs (and who meet the necessary criteria).
 - The relevant third party professional should be required to provide a sign-off at least each quarter (not every twelve months). It appears to us that, where technology is ever-changing and evolving, the requirement for a sign-off in each 12 month period is at odds with the continued involvement which is generally required of a responsible manager in a start-up FinTech company.

- There should be guidance within the industry for such third party professionals as to how they should conduct themselves with respect to maintaining confidentiality, in particular, where they may act as a third party providing sign-off to a number of FinTech companies with competing technologies. For example, ASIC may consider giving guidance to FinTech companies as to how to ensure that with each third party professional with whom they contract to provide the necessary sign-off, how to enter into suitable confidentiality arrangements (and may consider having a standardised short-form confidentiality agreement for use by FinTech companies that it may make available for this purpose).
- It appears that the proposal at present is restricted to FinTech companies offering robo-advice products and we would recommend that it may be broadened to other types of financial products or services which are provided through a technological application.

We consider that, for this proposal to be effective, ASIC will need to issue comprehensive guidance as to:

- The criteria for who may provide the third party professional sign-off function;
- Appropriate fee structures for providing this role within the industry (through working with and collaborating with industry); and
- Appropriate conduct with respect to confidentiality and managing conflicts which both the third party professional and FinTech companies should be aware of and manage.

This proposal should also apply to a broader spectrum of FinTech companies, not just those providing robo-advice, if this proposal is to properly assist the Australian start-up FinTech community.

(b) Regulatory sandbox exemption

In our experience, the cost of obtaining an AFSL is generally between \$15,000 and \$20,000, which can be prohibitive for a number of start-up FinTech companies. Therefore, we welcome the proposal of an industry-wide 'regulatory sandbox exemption'. However, we consider the proposed limitations suggested in the proposal to be imposed by ASIC will prevent the 'regulatory sandbox exemption' from allowing start-up FinTech companies to maximise the benefit of being able to test their products without the need for an AFSL.

Our key concerns with the current form of the proposal (and our suggested alternatives) are:

- (i) **(six month time period)** in our view, limiting the regulatory sandbox exemption to six months will not give start-up FinTech companies enough opportunity to adequately test their products and adapt the product as appropriate. We consider that the regulatory sandbox exemption should be for 9- 12 months. In

doing so, we would expect that the majority of start-up FinTech companies will have had the opportunity to test their products, and decide whether to apply for an AFSL in such a period. We also consider that there should be a process for a FinTech company to seek an extension of this period where they have applied for an AFSL and are waiting for it to be granted.

- (ii) **(only granting relief to a company once for a product)** we do not agree with this limitation. Start-up FinTech companies that test their product but need to re-shape it and relaunch it should be able to do so within the regulatory sandbox exemption, provided all of the requirements/ conditions are met.

Further, we assume that this limitation does not prevent a start-up FinTech company that wishes to test an unrelated product from relying on the regulatory sandbox exemption with respect to the unrelated product. Clarification on this point from ASIC would be appreciated.

- (iii) **(testing businesses may need to cease operations following testing period and being granted an AFSL)** we do not agree with this proposal. Start-up FinTech companies that rely on the regulatory sandbox exemption should not be expected to cease operations in the period between the end of the exemption period and the granting of an AFSL. As long as a start-up FinTech company applies for an AFSL within the regulatory sandbox exemption period, the start-up FinTech company should be able to continue its operations while the AFSL application is processed (a process that is outside the control of the start-up FinTech company).
- (iv) **(Australian businesses)** in order to encourage innovation in Australia, overseas start-up FinTech companies which operate as a registered foreign company in Australia and under current pass-porting arrangements should be able to take advantage of the regulatory sandbox exemption.
- (v) **(service restrictions)** we consider that the regulatory sandbox exemption could extend to services that involve consumer credit (where the relevant FinTech company has an ACL but not an AFSL) and business lending (where there is no ACL required).

We also believe that imposing a limitation on services relating to Australian listed/quoted securities goes against the principle of diversifying portfolios to manage risk. Therefore, it would be beneficial for consumers to be able to access services that have exposure to both Australian and overseas listed/quoted securities.

The regulatory sandbox exemption should also make a distinction between registered and unregistered managed investment schemes. Registered managed investment schemes offer greater protections for retail clients. Where the service relates to unregistered managed investment schemes, the exemption should permit investment in venture capital limited partnerships and early stage venture capital limited partnerships.

- (vi) **(not extending regulatory sandbox exemption to existing AFSL holders)** we disagree with this limitation. The only time an AFSL holder would need to rely on the regulatory sandbox exemption is when its AFSL did not contain the relevant authorisation for a particular product or service. In such a situation, there is no reason why the AFSL holder should not be able to obtain relief under the regulatory licensing exemption.
 - (vii) **(maximum exposure limits)** we agree that basing a consumer's exposure limit based on their net assets is too complex. However, we consider that the proposed \$10,000 maximum exposure for individuals is too low. Balancing this with the need to protect consumers, we consider a maximum exposure limit for individuals that are retail clients should be between \$25,000 and \$30,000. There should be no maximum exposure for individuals who are wholesale clients.
 - (viii) **(compensation arrangements)** we would like to envisage that insurers may develop specific products for start-up FinTech companies utilising the regulatory sandbox exemption. In our view, start-up FinTech companies will find it difficult to find an appropriate professional indemnity insurance product in the absence of a specific insurance product.
 - (ix) **(other consumer protections)** we consider that consumers need to be aware of the risks prior to entering into the product or service. Given the online nature of the majority of the start-up FinTech companies that we expect will participate in the regulatory sandbox, we suggest that a standardised 'pop-up' disclaimer be required to be used for all companies operating within the regulatory sandbox, whereby consumers are required to read the disclaimer and accept the disclaimer (i.e, acknowledging that the consumer is aware that the product or service is not covered by an AFSL by virtue of it being offered under the regulatory sandbox) before participating in the product or service.
 - (x) **(risk matrix)** we also consider that it may be useful for ASIC to work with industry to develop a short-form standardised risk matrix (in the form of a table) which all companies operating within the regulatory sandbox would be required to complete - which would set out the key risks to consumers of using the financial product or service based on a list of standardised criteria - and that such risk matrix is required to be placed by all FinTech companies using the regulatory sandbox on its website for consumers to have access to, who are considering using the relevant financial product or service. This would mean that companies using the regulatory sandbox provide adequate disclosure to consumers of the risks of using a financial product or service operating within the regulatory sandbox and consumers can more readily compare the risks associated with different products or services being offered within the regulatory sandbox.
- (c) **(sponsorship)** we believe the role of a 'sponsor' will be useful to the regulatory sandbox exemption, however, more information is required on the role and responsibilities of a sponsor. If sponsorship comes with liability, it may be an imposition on not-for-profits and innovation hubs, which may not wish to take on any such liability. Accordingly, it should be clarified by ASIC whether the role and

responsibilities of a sponsor will impose any liability upon a sponsor or whether, where a sponsor fulfils its role in accordance with ASIC's guidelines, whether it will be exempt from liability. In order to make the role and responsibilities of a sponsor clearly understood, we think it would be useful for ASIC to develop a standardised form which each sponsor is required to complete in confirming its role as sponsor and sign-off on at the beginning of the sponsorship, where such form sets out what:

- the sponsor's credentials are to provide sponsorship;
- the sponsor's involvement with and knowledge of the relevant FinTech company;
- the sponsor's role (and commitment) as sponsor, including what it is required to do as sponsor by way of testing; and what it has done by way of testing and why this is appropriate;
- the sponsor's checks it has carried out with respect to the business personnel – such as bankruptcy checks and police checks.

Such form could be lodged by the sponsor at the commencement of the regulatory sandbox exemption period. It could then be a requirement that this form must be updated (in respect of certain criteria) and re-confirmed at each six-month interval while the regulatory sandbox exemption is in place.

Further, similarly as with the third party professional sign-off function, we consider that ASIC should work with industry to promote an acceptable level of fees which may be charged for providing the sponsorship role, as well as provide guidance to sponsors and Fintech companies operating within the regulatory sandbox exemption as to managing confidentiality and conflicts.

Richard McMahon
Australian Securities and Investments
Commission
2 August 2016

We thank you for the opportunity to participate in this consultation process. Should you wish to discuss this submission with us further, please contact Michelle Seguert (Squire Patton Boggs (AU) on (02) 8248 7830 and michelle.segaert@squirepb.com or Hillary Ray (Hemisphere Legal) on 0400 788 672 and hillary@hemispherelegal.com.au.

Yours faithfully



Squire Patton Boggs (AU)



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