The fintech sector opportunity: ASIC perspective

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CHECK AGAINST DELIVERY

Thank you very much for having me here today at the 4th Annual FinTech Summit 2017.

Today's address is about opportunity – a topic regulators probably don't speak about enough.

As a regulator, you probably expect that I spend a lot more of my time thinking about opportunity's less lovable cousin – risk.

Regulators are, by way of nature, and legislative mandate, often more focused on risks than opportunities in the sectors they regulate.

But the financial sector is in the business of risk and reward. And so for us, perhaps even more so than in other sectors, risks are very closely intertwined with opportunities.

The fintech opportunity

The Macquarie dictionary defines an opportunity as 'an appropriate or favourable time or occasion'.

There are a couple of reasons I think we are in a favourable time for fintech, namely: trust, technology and consumer demand.

Trust

Trust is something clearly essential to the business of finance.

In the years following the global financial crisis, I think we can all agree that financial institutions have struggled to regain the trust of the community.

Author Rachel Botsman talks about technology enabling a shift from trust in institutions to a form of distributed trust. A kind of global village approach to trust.[1]

That is, I don't trust a large bank, merely because it is a large bank, and it *should* be trustworthy. Rather, I trust my friends, my family, and – this part is new – strangers on the internet – to give me advice about what I should do with my money.

This shift in trust away from large institutions is creating a space for fintechs to enter.

The reliance on digital peers also creates opportunities for those fintechs with a model that relies on these networks – peer-to-peer lending and crowdfunding come to mind.

Perhaps this is also part of the reason why the promise of distributed ledger technology has captured the interest of financial businesses worldwide.

And the erosion of trust is not just with respect to large institutions. For example, Roy Morgan research suggests that two important financial intermediaries – insurance brokers and stock brokers – are considered to be untrustworthy.

According to the survey:

> 'only 11 per cent of Australians, down 3 per cent, now rate Stockbrokers "very high" or "high" for their ethics and honesty and even fewer, just 10 per cent, rate Insurance Brokers "very high" or "high" for their ethics and honesty, down 1 per cent from a year ago.'[2]

So again, this erosion of trust creates the space for digital providers – such as robo-advisers or online brokers – to offer their services, and to create the kind of trust that is declining in more traditional financial providers.

Technology

The second reason we are in a time of opportunity for fintech, is technology.

Of course, without technology, there is no fintech.

Technological advances bringing changes to the financial sector is not new. But I would argue that in recent years technological developments have really shifted gears.

The internet of things, distributed ledger technology, artificial intelligence, deep-learning are converging faster than we might have predicted.

This technology opens the door for new and better financial products and services.

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[1] Rachel Botsman, ASIC Annual Forum 2017, 'Are you being served'
[2] http://www.roymorgan.com/findings/7244-roy-morgan-image-of-professions-may-2017-201706051543

Consumer demand

Closely related to my points on both trust and technology, is the growing shift in consumer demand. This is the third area I wanted to mention as creating the fintech opportunity.

In Australia, around 92 per cent of the population accesses the internet, and there are more mobile internet subscriptions than people in the country.

Consumers are also expecting more choice and better products, better interfaces and better service.

The rise of on-demand services like Netflix and Uber Eats may well carry over to financial services. Fintechs are in a position to meet the consumer desire to access financial products and services immediately, and from the comfort of one's own couch.

ASIC's approach

Three factors – trust, technology and consumer demand mean, in my view, that this is certainly a favourable time for fintech.

And as a regulator, we do see enormous opportunities presented by fintech.

Our view is that fintech has the potential to do a number of things:

- First, fintech can empower customers who can deal directly, more seamlessly, and flexibly with product and service providers.
- Secondly, fintech can empower businesses to deliver a better value proposition and customer experience to their customer base.
- Finally, technology can reduce the cost and improve the efficiency of product and service delivery.

In a highly-regulated sector such as finance, the approach and role of the regulator is critical in shaping the environment in which the fintech opportunity can be maximised.

For those who aren't familiar with us, ASIC is Australia's corporate, markets and financial services regulator.

Our vision is to allow markets to fund the economy and, in turn, economic growth. In doing so, we contribute to the financial wellbeing of all Australians.

We do this by promoting investor and consumer trust and confidence and fair and efficient markets.

Our legislation requires us to do a number of things as a regulator:

- We have to enforce the law.
- We have to maintain and improve the performance of the financial system and the entities within that system.

- We have to do that in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy.

So, we are explicitly required to work to reduce costs and improve the performance of the financial system to support the economy.

This is in the context of a broader government focus on increasing competition and customer choice in the financial sector.

The promise of fintech to increase choice and reduce costs to the benefit of consumers is a key reason we are looking to facilitate this part of the financial sector.

Our overarching aim is to maintain sensible and appropriate frameworks that harvest the benefits of innovation while fostering consumer trust and confidence in financial services.

So, when it comes to regulating for fintech, we are faced with the challenge of striking a balance between our commitment to encouraging innovation (and all of the opportunities created by fintech) without compromising on the proper regulation of financial products and services.

Our philosophy at ASIC, when looking at the regulation of fintech, has four components:

- being flexible and adaptable to the speed and nature of change,
- resisting the temptation to jump before we properly understand developments,
- ensuring – as far as we can – that our regulatory responses are technology neutral, and
- ensuring we have the skills and expertise to be an effective regulator in this space.

We are implementing this approach through our Innovation Hub.

Implementing our approach: regulatory sandbox

One specific example of how ASIC has tried to balance our objectives is via our regulatory sandbox.

The sandbox, launched December 2016, provides a 'lighter touch' regulatory environment to allow fintech businesses additional flexibility when they are still at the stage of testing their ideas.

Our world-first class waiver allows eligible fintech businesses to test certain services for up to 12 months without a financial services or credit licence.

We have taken a white-list approach. That means there is no ASIC review of each proposed product or service and we are not involved in selecting applicants and negotiating individual testing terms for people using the class waiver.

However, customers of these fintech businesses will still have fundamental protections under the law, such as dispute resolution and professional indemnity insurance.

As an added protection to consumers, we limit the types of services, the time period, the number of consumers and the amounts able to be invested by sandbox businesses.

The sandbox is intended to improve the opportunity for Australian fintechs in three key areas:

- First, it should help startups get to market more rapidly – by providing an environment for testing without a licence.
- Secondly, it enables greater flexibility in organisational competency – for example, so those with more tech experience can bring in the financial expertise from outside.
- Finally, we think that reduced testing costs should lead to increased access to capital.

You may also be aware the Government has announced an expanded sandbox with a longer testing time, and for an increased range of products and services.

Implementing our approach: Innovation Hub

The sandbox framework is an important part of our Innovation Hub, and I'll now briefly take you through what our Innovation Hub does and how it works more broadly.

Since its inception in March 2015, the Innovation Hub has worked with more than 200 entities.

The businesses are right across the spectrum of fintechs – those providing digital advice, conducting marketplace lending and crowdfunding, businesses providing consumer credit and payments and various others.[3]

Through the work of the hub, we have also granted 36 new licences to fintech businesses. Those business that seek licences via the Innovation Hub are granted those licences significantly faster than those who go through the normal process.

ASIC's Innovation Hub is focused on start-ups because we think that these new, small businesses have the most difficulty in accessing the resources and regulatory support they might need. The hub is partly a response to particular challenges faced by start-ups but also recognises that innovative products and services often do not fit within existing rules and policy.

Of course, we also meet with existing businesses in the ordinary course of our work.

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[3] The breakdown of businesses who have contacted the Innovation Hub is:

- 38 - digital advice
- 35 - marketplace lending
- 18 - crowd sourced funding
- 25 - consumer credit
- 28 - payments and remittances
- 56 - other (including insurance, superannuation, markets, managed investments).

There are three key elements of our Innovation Hub that help us understand and support innovative new fintech companies.

First, we engage directly with fintech and regtech entities, as well as physical hubs and co-working spaces for start-ups.

- We make it easy for fintech and regtech businesses to contact us, and we often go to fintech events to explain what we do and answer questions.
- We have also established a Digital Finance Advisory Committee comprising representatives from the fintech community, academia and consumer groups.

Secondly, we give informal assistance to eligible entities. This help is intended to get new businesses to consider important issues early on in their development.

- Working together with the regulator helps businesses to understand how our regulatory system applies to them in an efficient and effective manner. It also helps to ensure that new businesses are starting up within the regulatory framework, rather than outside it.
- For us, as a regulator, the benefit of holding discussions with the fintech industry is that it helps us to identify and learn about new technologies being used in the market.
- This in turn assists us in understanding how we should treat these innovative products and services under our regulatory framework.

Finally, we can give tailored guidance for innovative businesses to access information and services relevant to them via our website.

So far, we have provided a range of tailored guidance, including examples on:

- digital (robo) advice
- marketplace (peer to peer) lending
- distributed ledger technology, and
- initial coin offerings.

Implementing our approach: ICOs

I spoke before about our approach to fintech – I think our work on initial coin offerings (or ICOs) – is a good reflection of some of those principles – in particular, being flexible and adaptable, and resisting the urge to jump before we properly understand developments.

ICOs are an important market development and we think they can make a contribution to the capital-raising options for businesses.

In our view, to promote trust and confidence in ICOs, it is important that they comply with applicable laws.

We have given guidance explaining that an ICO or the tokens that are issued may fall under various existing laws, however, we have not made any changes to the existing framework.

We are also strongly encouraging businesses conducting or planning to conduct an ICO to come and talk to us through ASIC's Innovation Hub.

An important part of understanding ICOs and shaping our response was our international engagement. ICOs have been vexing regulators well beyond our borders, and through our international networks, we have been able to learn more and reflect on appropriate responses.

What about the risks?

I've shared with you what I believe is shaping the environment to create the fintech opportunity, and I've talked a bit about what we at ASIC are doing to ensure that we are contributing to that favourable moment for fintech.

So now I want to come back to risks.

As I have said, we attempt to balance the promotion and encouragement of innovation with ensuring that investors and consumers can have trust and confidence in the financial system, and ensuring that markets operate fairly and efficiently.

So it hasn't escaped our notice as a regulator that those forces I spoke about earlier that are creating the opportunity for fintech, are also contributing to risks.

Trust

First, I'll return to trust.

Even with the potential advantages of agility and responsiveness and distributed trust, fintechs still need to gain the confidence of their customers, and the public more widely.

It is in our interests as a regulator to ensure consumers can trust financial businesses – fintech or otherwise – but it is also in the interest of fintech businesses to ensure that they are trusted.

This is particularly critical for new, untested business models, products and services. Importantly, poor conduct or poor consumer outcomes in one area of fintech may well have ripple effects for all fintech.

A particularly important component of maintaining consumer trust in the digital world is around data security and privacy. I expect this to become increasingly relevant over the next couple of years for a number of reasons.

Firstly, consumers are becoming more and more savvy about the value and use of their personal data. The appropriate gathering and protection of consumer data will also be impacted by external forces, like open banking in many places, including Australia and the new European General Data Protection Regulation will raise the stakes for data protection.

To ensure that trust is retained, firms need to ensure their data storage and sharing arrangements are secure and private. Specifically, customers need to be confident that their personal data cannot be accessed inappropriately or used without their permission.

Consumer demand

Moving on to consumer demand.

We think that there is a risk that streamlining consumer engagement can result in people not understanding what they are buying.

A slick interface and a new app are not a substitute for genuinely good consumer experience and useful and effective products and services.

Similarly, fintech developments can contribute to complexity – and while complexity is to be expected in some cases, it should not be used to obscure or mislead.

It is our view that technology should be used to improve experiences and achieve efficiencies, but it is not an excuse for financial business to shift risk to consumers or other parts of society without being very clear that is happening.

This is particularly important as we move into ever-increasing automation and machine-based decision making.

We need to make sure we do not neglect the issue of accountability.

No matter how far technology and innovation goes, and how intelligent machines become, at the end of the day, people need to remain responsible for the products and services they sell and the decisions they make.

When using technologies like AI or other automated decision-making tools, there needs to be a person who is responsible for its design – and its outcomes. Automated decisions must also be capable of clear explanation, to the consumer, to the regulator, and to any other interested stakeholders.

Finally, if and when automated decisions go wrong, and they will, whether because of data errors or issues with their design, there need to be clear remedies.

Technology

It is no secret that the increasingly digital nature of our financial environment means that cyber threats are creating more and more risk.

In 2016, almost two-thirds (62%) of directors in Australia's top 100 publicly listed companies witnessed an increase in attempted malicious cyber activity, and 80% expect a rise in cyber risk over the next year or so.

Cyber threats do not just pose risks to business operations, they can also:

- threaten customers' personal information,
- result in direct client losses,
- damage a firm's reputation, and
- compromise market integrity.

Our experience is that larger, more sophisticated firms tend have better cyber-resilience than their smaller counterparts.

The digital nature of fintech, and smaller sized startups therefore amplify the cyber risk, so it is essential that fintechs are alert to this risk and ensure that appropriate responses are in place.

Conclusion

We are undeniably in a fintech moment.

The promise of fintech, to increase competition, to improve consumer experience and to reduce costs, is something that regulators can definitely get behind.

And we are – I have outlined today some of the steps we are taking to ensure that as a regulator we contribute to the favourable time for fintech development. And importantly, that we don't stand in the way of innovation.

The forces that are driving this fintech moment – consumer demand, trust and technology are also bringing risks.

It is incumbent upon all of us to maximise this opportunity for the benefit of investors and financial consumers.