FINANCIAL PLANNING ASSOCIATION *of* AUSTRALIA

6 November 2017

Shellie Davis
Senior Adviser
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: sandbox@treasury.gov.au

Re: **Treasury Laws Amendment (Measures for a later sitting) Bill 2017: FinTech Sandbox Regulatory Licensing Exemptions**

Dear Shellie,

The FPA welcomes the opportunity to provide a submission on encouraging innovation in financial services. The FPA believes genuine innovation should be encouraged. However, we are opposed to Government providing an automatic exemption from the requirements of the licensing regime. In our view, each proposal for relief must be assessed on its net benefits.

We also do not support Government limiting its proposed flexible approach to meeting the organisational competence requirements, in the way it has outlined. We believe that if flexibility does not increase risk to consumers, the broader industry should also allowed to use this option. There are other ways, which we detail in our submission, to encourage innovation which don't deny flexibility to the broader financial services industry.

If you have any queries or comments, please do not hesitate to contact me.

Yours sincerely

Benjamin Marshan

Head of Policy and Government Relations
Financial Planning Association of Australia[1]

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[1] The Financial Planning Association (FPA) has more than 13,000 members and affiliates of whom 11,000 are practising financial planners and 5,600 Certified Financial Planner® professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and super for our members – years ahead of FOFA.
- An independent conduct review panel, Chaired by lawyer Graham McDonald, deals with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules required of professional financial planning practices. This is being exported to 26 member countries and 170,000 CFP® professionals of the Financial Planning Standards Board.
- We established the Financial Planning Education Council in 2011 as an independent body chartered with raising the standard of financial planning education. The FPEC has built a curriculum with 17 Australian Universities for Bachelor and Master degrees in financial planning
- We are the only professional body in Australia licensed to provide the CFP® certification program. CFP® certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP® standing are equal to other professional designations, such as the Chartered Accountant designation of the Chartered Accountants Australia and New Zealand (CA).
- We are also recognised as a professional body by the Tax Practitioners Board.

TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL 2017: FINTECH SANDBOX REGULATORY LICENSING EXEMPTIONS

FPA submission to:
Treasury

6 November 2017

INTRODUCTION

The FPA is strongly in support of innovation in the provision of advice to Australian consumers. However, such support should not come at the cost of denying flexibility to the industry at large. Nor should it mean that consumers are placed at additional risk.

In principle, we believe there should be a level playing field across all ASIC regulated advice and product distribution businesses. This means the Government should maintain its general principle of being channel and technology agnostic in the legal frameworks it imposes on the financial services sector.

If the AFSL application/RM burdens are too high for a new business, Government should consider generally removing or simplifying them if they feel the current risk environment justifies this. If not, these requirements shouldn't be lessened.

If a company wants to try something novel and really innovative, Government should give it the ability to test this. (Throughout our submission, we refer to the testing environment as the sandbox.) Therefore Government's prime consideration for allowing new fintechs to test their new technology should be based on the firm's ability to prove it is being truly innovative rather than just providing a heavily automated version of an existing process or technology.

Further, we also need to consider need and risk. Is there a net benefit to Australian consumers after risk is taken into account? While the sandbox proposal is novel and exciting, in its proposed operation it places consumers at risk from inexperienced advice and product providers. Further, we are concerned as to whether businesses who need regulatory assistance to get to market, would have appropriate compensation resources if needed.

We also question whether providing a default environment for new fintech offerings may lead to businesses which would have the ability to meet their regulatory obligations prior to testing, seeking to avoid these obligations. We accept that smaller firms are more likely to need relief, but again this should be demonstrated based on the novelty of the solution they have developed.

We believe this lens provides a fairer and more effective way to encourage innovation and, in turn, we believe an automatic exemption is inappropriate. In summary, each case needs to be judged on its merits. We should not let our excitement for the idea of innovation blind us to the risks and place consumers in a riskier environment.

As we have raised with Treasury previously, we are also concerned by the draft Bills lacking a significant amount of detail and therefore creating shell legislation where the content of the obligations to be imposed on industry is made by delegated powers.

The Scrutiny of Bills Committee Terms of Reference specifically test whether new legislation:

- trespass unduly on personal rights and liberties;
- make rights, liberties or obligations unduly dependent upon insufficiently defined administrative powers;
- make rights, liberties or obligations unduly dependent upon non-reviewable decisions;
- inappropriately delegate legislative powers; or
- insufficiently subject the exercise of legislative power to parliamentary scrutiny.

The FPA understands the desire to ensure there is flexibility within the legal framework to create an environment for innovation in financial services and allow Government to appropriately amend certain aspects of the obligations as necessity arises and in response to any changing regulatory demands being placed upon the Regulator. However, the risk of consumer detriment created by lesser regulatory standards in relation to bringing new solutions to market should require any significant changes to be required to go through appropriate due process with parliamentary oversight.

It is difficult to support the Bills as they merely create the legal framework and ability for ASIC to approve companies to put to market products with less information, lesser regulatory obligations, and no licensing requirement.

It is important to remember that Government is currently considering the implications for failed consumer protections through the Ramsey Review considering a compensation scheme of last resort for the financial services sector. This suggests the even the current regulatory environment is failing to appropriately protect consumers when purchasing financial services. Allowing products to come to market that would not meet the current licensing obligations, and would not be subject to appropriate regulatory oversight is likely to compound this issue further, not lead to an improvement in the consumer protections of consumers.

We would further highlight that ASIC is just one of seven financial service regulators, and we question whether obviating the need to be licensed with one regulator will really reduce the cost for new businesses to come to develop their service/product offers when the history of the financial services industry in Australia shows many examples of novel offers coming to market without lessening consumer protections.

This is a matter of due process and procedural fairness in imposing a very significant exemption in the licensing regime on industry and ultimately affecting the financial security of all Australian consumers.

FPA Response

The FPA supports flexibility and innovation in the financial services industry. However, we believe that administrative flexibility that doesn't increase risk to consumers should be available to the industry generally; and that relief from licensing requirements should be based on a close examination of the costs and benefits of the particular case.

In principle, we agree with Government putting in place additional measures to facilitate flexibility. A flexible approach by the regulator will help increase the efficiency of the industry.

The FPA therefore supports a framework where requests for relief should be assessed case-by-case, based on consideration of need (of the firm) and of the trade-off between true innovation and risk to the consumer. We note that the UK Financial Conduct Authority's (FCA's) approach to assessing applications for relief is based on the testing business showing: genuine innovation; consumer benefits; understanding of regulation; and need for support.[2]

We would support a framework in which ASIC gives special weight to applications for relief for truly innovative business ideas, especially for testing the idea. This would reduce barriers to innovative firms entering the market, and in turn promote the spill-over benefits of innovation.

To be clear, a heavily automated business is not necessarily innovative. Nor is yet another automated risk profiling tool or an ETF investing tool. Firms should demonstrate they are genuinely innovative. Simply being heavily automated is not enough. A close investigation is required to decide whether the firm is offering something genuinely novel and beneficial.

We would also support giving special consideration to the size of the firm, as smaller firms may find it particularly difficult to enter the market. But, again, being small and heavily automated does not make a firm truly innovative (let alone innovative enough to outweigh the extra risk).

In summary, a general exemption is inappropriate as there is a need to ascertain whether there is a net benefit. This requires a close examination and a judgement. We should not let our excitement for the idea of innovation blind us to the risks.

Further, we would support providing access to the sandbox, for true innovation regardless of its source; for example, whether or not the firm is an existing AFSL - even an existing AFSL, the modified disclosure and compensation arrangements of the sandbox might be highly attractive. We see no good reason for restricting relief based on factors that aren't indicative of innovation, risk or need.

If increased flexibility would not materially increase risk to consumers, there is no strong reason for limiting the approach to a narrow group of firms. While encouraging innovation is important, so is promoting efficiency across the industry. Providing flexibility to the entire industry will enhance its efficiency. In a nutshell, the disadvantage of limiting these proposals is that it represents a wasted opportunity to enhance the efficiency of the broader industry.

We believe this approach will put consumers at an excessive risk of inappropriate advice and product placement, relative to the current regime. We believe that consumer protection is a proper constraint on the industry and should not be eased except in special cases which would include an emergency situation where the risk of no advice outweighs the risk of advice under relaxed consumer protections. In our view, pursuing the policy goal of encouraging innovation is not a special case. In turn, we strongly recommend that the framework ASIC uses assess each particular case on its merits, including consideration of risk to consumers and innovation benefits. As mentioned, special weight could be given

[2] see http://www.fca.org.uk/static/documents/project-innovate-criteria.pdf

to firms seeking to test their innovative business idea, without automatically allowing such firms to enter the sandbox.

One area we are particularly concerned about is that even if the client is not put at excessive risk, there would need to be adequate compensation arrangements in place. It may be difficult or prohibitively expensive for providers (especially smaller ones) to obtain professional indemnity insurance. Alternatives such as group schemes would need to be considered. In our view, these alternative schemes would need to, at least, mirror professional indemnity schemes. This would imply that they would need to be funded by government (or the broader industry, which would require government intervention).

If there is no appetite for such intervention, the only alternative is reducing the quality of compensation. In our view, this is unacceptable as consumers are exposed to a greater extent, in circumstances where risk is high. It irrelevant that providers must disclose to consumer the risks (including special risks) the consumer faces; as already mentioned, our starting point is that reforms must not excessively weaken consumer protections.

An alternative is to create a virtual sandbox where providers can simulate how consumers would be expected to respond to the provider's business. The simulation would be based on simulation model and a detailed data set. We understand the UK's FCA is working with industry to develop a virtual sandbox. This provides special support for these firms (in line with the policy objective), without exposing consumers to any extra risk.

Further, the small exposure limits are a double-edged sword. On the one hand, some consumers may treat the investment as speculative, and not behave in the same way they would in the real market (i.e. where there are no caps on investments). On the other hand, a $10,000 investment, or $40,000 worth of super can still be a large investment for many consumers and losses could have a significant impact on their lives. We also question whether the proposed life insurance cover limits will in fact be appropriate for any consumers which could lead to significant underinsurance outcome for consumers who are legitimately engaged and looking for an appropriate level of life insurance cover.

On another practical note, the proposed exemption would create an incentive for firms not otherwise covered, to restructure. For example, an existing firm that wants to test a digital advice idea, potentially using existing clients, may create a new entity so as to fall within the exemption. Complex anti-avoidance provisions (and associated monitoring) would be required to prevent this sort of exploitation. This regulatory cost could be reduced by adopting a more flexible approach.

We also note that the disclosure obligations required in the financial services sector are all aligned to the providers AFSL. It is virtually impossible for a financial services provider to meet their disclosure obligations if they are not providing information about their AFSL.

As an alternative to these proposals, we would suggest the following positive measures to encourage innovation:

- ASIC introduces a priority service for all providers, which would provide faster service to all firms who pay an additional fee. As discussed, below the fee could be waived, reduced or deferred for truly innovative firms (especially small firms).
- ASIC waives (or reduces below cost) fees and levies charged (e.g. assessment) to truly innovative firms (especially small firms). Alternatively, such firms can defer payment of fees and levies until they can afford it, under a similar system to HECS-HELP used in the education system.

Finally we note that this legislative framework only provides an exemption to a fintech provider from the some obligations required to obtain an AFSL with ASIC. Based on the Governments current regulatory architecture, financial service providers are regulated by 7 regulators – ASIC, APRA, TPB, AUSTRAC, CIO, ATO and FASEA - all with significant legislative and regulatory practice standards to comply with. Depending on the services being provided, registration and compliance will be required with all 7 of these regulators – including ASIC (all be it in a slightly modified manner). We would note that the Governments moves to user pay funding models for these regulators (plus AFCA) is leading to further increasing costs[3]. Given this overall consumer protection and regulatory architecture, similar regulatory obligations across multiple regulators, there doesn't appear to be a significant cost and regulatory saving by obviating the need to meet the AFSL obligation this legislation will lead to. We therefore recommend Government consider whether this legislation will have the desired cost savings for new financial services providers.

[3] FPA Submission – Productivity Commission Inquiry – Competition in Australian financial services - Inquiry into competition in the Australian financial services