

# FINANCIAL TECHNOLOGY: INNOVATIONS TO DRIVE POLICY AND REFORM



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What is financial technology, or fintech? An emerging global financial sector applying technological innovation to reduce information asymmetry and resultant risk in the marketplace; the promotion of disruption in the financial services sector through innovative new products and services; technological innovation allowing financial markets and systems to become more transparent, efficient and consumer-focused; and 'data monetised and money digitised'.

Fintech is said to be all of these things and, with its development, we have seen it adapt and challenge the regulatory landscape to deliver new financial products and services. In the Australian experience we have seen new retail investment, market place lending, crowd funding platforms and other online products coming to market.

In Australia, where fintech is seen as a focal point for economic growth, it is accepted that policy and reform in the financial services sector will be driven by fintech innovations. These platforms in particular have progressed the traditional thinking and regulatory treatment around regulated collective investment vehicle structures and the application by regulators of the existing legal framework. Beyond being new service and product offerings of themselves, the delivery of these platforms to the market – and seeing them in practice – is not only opening up possibilities for other businesses to enhance their service or product offering but is also demonstrating the possibilities of the development and aggregation of fintech to realise new products or services.

Fintech is subject to an extensive regulatory regime that includes registration, licensing and disclosure requirements; competence, capacity and conduct obligations; prudential standards; consumer protection (on multiple fronts); anti-money laundering; counter-terrorism; and privacy. The regime is administered by several regulators and navigating it is enough of a challenge for the well-resourced and experienced players, let alone a start-up looking to test a product in the market and align it with consumer and market expectations and demands.

For retail market place lending or fractionalised property investment platforms,

the registration and licensing requirements associated with collective investment structures and liquidity mechanisms that generally capture these platforms can be particularly challenging. Not only due to the complexity and onerous regulatory requirements, but also the "out of the box" thinking required to create a structure that fits into the existing legal framework, the need to challenge the traditional and comfortable thinking around how the framework has typically been applied and the need to demonstrate that the necessary regulatory outcomes are being achieved.

The Australian government and regulators have generally been responsive to facilitating the development of these platforms. More broadly we've seen the \$1.1 billion National Innovation and Science Agenda promoting commercial risk taking and encompassing tax incentives for early stage investment in fintech companies, changes to the venture capital regime, insolvency law reforms, the establishment of the FinTech Advisory Group to advise the Treasurer, the ASIC innovation hub and the proposed expansion of the yet to commence crowd sourced equity funding regime to include debt funding.

In addition to these measures, ASIC has recently announced its consultation in relation to a proposed "regulatory sandbox," which will involve proposals to provide greater clarity around the skills and experience required by new businesses to be granted an Australian financial services licence, additional flexibility around demonstrating 'organisational competence' in relation to restricted authorisations and a regulatory sandbox exemption enabling new businesses to run early-stage tests and trials.

Along with the broader measures, the regulatory sandbox exemption will be an important tool for early stage fintech as it proposes to address some of the key regulatory challenges for the industry, and certainly those that have arisen in connection with the development of the fintech platforms discussed earlier. These challenges have translated to timing and costs burdens that are not necessarily balanced with the scalability of the product or risk associated with the product being offered on the platform.

The features of the proposed regulatory sandbox include a testing window, allowing certain financial services and products to be provided without a licence; an ability for sophisticated investors to participate with a limited number of retail clients with separate monetary exposure limits; consumer protections (external dispute resolution and compensation arrangements would typically apply in the retail environment); and modified conduct and disclosure obligations.

In an economy where resources and manufacturing are slowing, the services sector comprises approximately 20% of our exports. With financial services making up only 5% of those exported services, the potential economic benefits of fintech, and the need to foster its success, are clear. As a result, the government and regulator responses referred to above are timely. More so, when you take a moment to consider the possibilities, even if only in relation to the platforms brought to market to date.

Many possibilities come to mind beyond the growth in the professional services that assist with establishing new products and disrupting incumbent providers. For example, blockchain, sidechain and smart contract technology facilitating liquidity and implementation of robo-advice; or robo-advice contemplating the products and services available on fintech platforms. Fintech platforms could comprise approved products for planners and dealer groups where algorithmic savings

and investment tools could be coupled with investment platforms. Crowd sourced equity and debt funding platforms could offer liquidity in relatively illiquid markets and the automatic execution of participant investments could de-risk certain aspects of these markets.

These relatively apparent possibilities (for the innovators there are no doubt many more) are not so far-fetched when we consider the interplay between the policy considerations in relation to fintech that are already on the radar. These include (among other things) enabling better access to data, the development of more efficient and accessible payment systems, the need for comprehensive credit reporting, the proposed treatment of digital currency as money, the proposed regulatory sandbox and big data. We are also seeing the government becoming a participant via its 'digital transformation office' seeking to provide better access to government services online and looking to create a digital market place for SMEs and start-ups to deliver digital services to government.

In the private sector, blockchain and smart contract technologies, which already exist and are available to business, are the subject of significant investment and are being investigated extensively at the institutional level. We are experiencing firms seeking to position Australia as a centre for funds management and managers and

other participants in the financial services sector expanding their operations globally, particularly in the Asia Pacific region.

The regulatory barriers are also coming down – representatives from Australia, Japan, Korea and New Zealand recently signed the Asia Region Funds Passport's Memorandum of Cooperation, which relates to facilitating the offering of qualifying retail products that are generally subject to the same regulatory regime as fintech among participating economies and the UK's Financial Conduct Authority (FCA). ASIC recently signed an agreement to ensure certain innovative fintech companies in Australia and the United Kingdom will have support from regulators as they attempt to enter each other's markets to help reduce regulatory uncertainty and time to market.

The Australian Government and regulators seem keen to ensure regulation does not stifle the growth of fintech, and are eager to involve fintech participants in developing the regulatory framework. Expect to see continued movement in the regulatory landscape and opportunities to participate in informing the direction this movement takes, particularly given the environment for testing offerings. Alongside this regulatory development, the expansion of the fintech sector via fintech building fintech, and the role of aggregation of fintech to facilitate new product offerings, seems inevitable. <sup>a</sup>

