THE FINANCIAL TECHNOLOGY LAW REVIEW

Editor
Thomas A Frick

THE LAWREVIEWS

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PREFACE

This first edition of *The Financial Technology Law Review* is published at a time when most players in the finance sector are concerned about the new developments that information technology (IT), big data and artificial intelligence (AI) will trigger in the finance sector. Hence, it is often forgotten that the use of IT in the finance sector is not new and that many applications that would come under fintech are already quite old, at least by today's standards. Financial market participants – and their legal advisers – already have considerable experience in implementing such changes. As far as improved support products are concerned, the general rules of financial regulations can be applied quite easily to new developments.

However, there are indeed some recent developments that are entirely new, such as AI and the blockchain and its various applications, such as other tokens (e.g., cryptocurrencies and security tokens). These do have the potential to disrupt the industry, in at least some of its sectors.

The regulators worldwide were taken by surprise by the sheer dynamism of this development, both by the speed of the technical developments and the speed with which such new possibilities were implemented: long before there were any established rules for ICOs, startups could already raise up to several hundred million dollars by issuing tokens. This may have been a golden window of opportunity, but also, as one article published put it, 'good times for money launderers'.

Therefore, it is little wonder that we are currently witnessing a strengthening of regulations in the field of fintech. However, the national solution chosen (and the speed with which regulators are willing to react by providing guidelines to market participants) varies considerably between jurisdictions. This may be a consequence of different regulatory cultures, but in addition, the existing legal systems may pose varying and unplanned obstacles to some of the new applications. It may, for example, be difficult to transfer rights on the blockchain if the national code prescribes that rights can only be assigned in writing. Therefore, a structured collection of overviews of certain aspects of fintech law and regulation – as this publication provides – is valuable not only for the international practitioner, but also for anyone who is looking for inspiration on how to address hitherto unaddressed and unthought-of issues under the national law of any country.

The authors of this publication are from the most widely respected law firms in their jurisdictions. They each have a proven record of experience in the field of fintech; they know both the law and how it is applied. We hope that you will also find their experience invaluable and enlightening when dealing with any of the varied issues fintech raises in the legal and regulatory fields.

The emphasis of this collection is on the law and practice of each of the jurisdictions, but discussion of emerging or unsettled issues has been provided where appropriate. The views expressed are those of the authors and not of their firms, the editor or the publisher. In a fast-changing environment, every effort has been made to provide the latest intelligence on the current status of the law.

Thomas A Frick
Niederer Kraft Frey
Zurich
April 2018

Chapter 1

AUSTRALIA

Peter Reeves[1]

I OVERVIEW

Financial technology (fintech) has been a focal point for economic growth in Australia and within the financial services sector, it has generally been accepted that policy and reform are driven by fintech innovations. In the past two years alone, the number of active fintech businesses in Australia has doubled. This rapidly evolving and growing landscape has resulted in a willingness by the Australian regulators and policy-makers to facilitate fintech innovation.

Throughout 2017, regulatory and legislative frameworks were subject to review so as to encapsulate innovations that may not have necessarily fit within existing regimes. More broadly there has been A$1.1 billion invested in a National Innovation and Science Agenda promoting commercial risk taking and creating tax incentives for early-stage investment in fintech companies, changes to the venture capital regime, insolvency law reforms, and the establishment of the FinTech Advisory Group to advise the Australian Treasurer.

Regulators have committed to helping fintech businesses by streamlining access and offering informal guidance to enhance understanding, with both the Australian Securities and Investments Commission (ASIC) and the Australian Transaction Reports and Analysis Centre (AUSTRAC) Innovation Hubs available to assist start-ups in navigating the Australian regulatory framework. AUSTRAC's Fintel Alliance has an Innovation Hub (the Hub) targeted at improving the fintech sector's relationship with government and regulators. The Hub includes a regulatory sandbox in which fintech businesses may test financial products and services without risking regulatory action or costs by AUSTRAC. ASIC has released public guidance on topics for fintech business such as providing digital financial product advice, distributed ledger technology (DLT) and initial coin offerings (ICO).

To assist businesses wishing to create a new financial service product or to understand their anti-money laundering and counter-terrorist financing obligations, AUSTRAC has also implemented a new dedicated webpage providing information about the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) regime and AUSTRAC's role. In their annual report for 2016–2017, AUSTRAC noted that the webpage had been successful, garnering over 40 direct enquiries from entities developing innovative new approaches to providing 'designated services' as defined under the AML/CTF Act.[2]

In terms of tax incentives, Australian fintech companies may be eligible for the Research and Development (R&D) Tax Incentive programme, which is available for entities incurring

1 Peter Reeves is a partner at Gilbert + Tobin.

2 Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth).

eligible expenditure on R&D activities.[3] This includes certain software R&D activities commonly conducted by fintech businesses. Claimants under the R&D tax incentive may be eligible for:

a small businesses (less than A$20 million aggregated turnover): a 43.5 per cent refundable tax offset; and

b other businesses: a 38.5 per cent non-refundable tax offset.

The government has also introduced a bill proposing changes to the venture capital and early-stage tax concession provisions in the Income Tax Assessment Act 1997 (Cth).[4] The proposed changes mean that start-up fintech businesses will be eligible for certain venture capital investment tax concessions. This is a change from the current regime in which investments into companies whose activities are financial or insurance related do not qualify for venture capital investment tax concessions, which has limited venture capital investment in start-up fintech businesses.

Finally, the government has also committed A$8 million to an incubator support programme to assist innovative start-ups by providing funding, mentoring, resources and business network access.

II REGULATION

i Licensing and marketing

Licensing

Fintech businesses carrying on a financial services business in Australia must hold an Australian financial services licence (AFSL) or be exempt.[5] The Corporations Act 2001 (Cth) (the Corporations Act), which is administered by ASIC,[6] defines a financial service to include the provision of financial product advice, dealing in financial products (as principal or agent), making a market for financial products, operating registered schemes and providing custodial or depository services.[7] A financial product is a facility through which, or through the acquisition of which, a person makes a financial investment, manages a financial risk or makes a non-cash payment (NCP).[8]

These definitions are broad and often capture the regulation of investment, asset management, market place lending, crowdfunding platforms, payment services and other fintech offerings. Certain financial product advice will also require an AFSL, including the provision of automated digital advice so long as it can reasonably be regarded as intending to influence a client to make particular financial product decisions.[9]

3 'Research and development tax incentive' (Australian Taxation Office, 2017), https://www.ato.gov.au/Business/Research-and-development-tax-incentive/.

4 Treasury Laws Amendment (Measures for a later sitting) Bill 2017: Fintech and venture capital amendments.

5 Corporations Act 2001 (Cth) s 911A.

6 'Laws we administer' (ASIC, 2017), http://asic.gov.au/about-asic/what-we-do/laws-we-administer/.

7 Corporations Act 2001 (Cth) s 766A.

8 Corporations Act 2001 (Cth) s 763A.

9 Corporations Act 2001 (Cth) s 766B; ASIC, Regulatory Guide 225: Providing digital financial product advice to retail clients, August 2016, RG 255.18-30.

In December 2016, to encourage investment in the fintech sector ASIC released a guide detailing its framework for fintech businesses seeking to test products or services before obtaining an AFSL or Australian credit licence (ACL) (referred to as the regulatory sandbox) for 12 months.[10] There are strict eligibility requirements for both the type of businesses that can enter the regulatory sandbox and the products and services that qualify for the licensing exemption. Once accessed, businesses may utilise the sandbox for up to 100 retail clients, as long as certain consumer protection conditions are met and a notification is made to ASIC of the intention to conduct business. The framework has been subject to review, with the government recently closing consultation and releasing a paper suggesting that no changes to its existing fintech licensing exemption be made. In addition to this, the government has introduced a bill to enhance the existing regulatory sandbox to allow businesses to test a wider range of financial products and services for a longer period of time without requiring a licence.[11]

Consumer lending is regulated in Australia under the National Consumer Credit Protection Act 2009 (Cth), which is also administered by ASIC. Fintech businesses carrying on consumer credit business in Australia need to hold an ACL, or be exempt.[12] This includes providers of marketplace lending products and related services, such as peer-to-peer lending and crowd-lending platforms, who are also required to hold an AFSL.

In addition, the provision of credit information services in Australia is subject to the Privacy Act 1988 (Cth) (Privacy Act), which provides that only credit reporting agencies (i.e., corporations carrying on a credit-reporting business) are authorised to collect personal information, collate it in credit information files and disclose it to credit providers. Credit reporting agencies must comply with obligations with regard to use, collection and disclosure of credit information.

Cloud computing is permitted for financial services companies. From a risk and compliance perspective, the same requirements, tests and expectations apply to cloud computing as would apply to other areas of a financial services business. ASIC has released regulatory guidance indicating its expectations for licensees' cloud computing security arrangements.

Marketing

Marketing financial services may itself constitute a financial service requiring an AFSL. If financial services will be provided to retail clients, a financial services guide must first be provided, setting out prescribed information, including the provider's fee structure, to assist a client to decide whether to obtain financial services from the provider.[13]

Generally, any offer of a financial product to a retail client must be accompanied by the relevant disclosure document that satisfies the content requirements of the Corporations Act. There are exemptions from the requirement to provide a disclosure document in certain circumstances (e.g., a small-scale offer) and where the offer is made to wholesale clients only.

10 ASIC Regulatory Guide 257: Testing fintech products and services without holding an AFS or credit license, August 2017, RG.

11 Treasury Laws Amendment (2018 Measures No. 2) Bill 2018.

12 National Consumer Credit Protection Act 2009 (Cth) s 27.

13 Corporations Act 2001 (Cth) s 941A.

Marketing materials must not be misleading and deceptive and are expected to meet certain ASIC advertising guidance.[14]

ii Cross-border issues

Passporting

Carrying on a financial services business in Australia will require a foreign financial service provider (FFSP) to hold an AFSL, unless relief is granted. Australia has cooperation (passporting) arrangements with regulators in foreign jurisdictions, which enable FFSPs regulated in those jurisdictions to provide financial services to wholesale clients in Australia without holding an AFSL.

Passporting relief is available subject to the FFSP satisfying certain conditions, including lodging prescribed documentation with ASIC evidencing registration under the laws of the home jurisdiction, consenting to ASIC and the home regulator's sharing of information, appointing an Australian local agent and agreeing to comply with orders made with respect to financial service providers in Australia.

The passporting relief is only available in relation to the provision of services to wholesale clients, and the FFSP must only provide the services it is authorised to provide in its home jurisdiction.[15] Before providing financial services it must disclose to clients that it is exempt from holding an AFSL and it is regulated by the laws of a foreign jurisdiction.[16]

FFSPs that are currently provided with passport relief through class orders in Australia include the United Kingdom,[17] the United States SEC, CFTC, Federal Reserve and OCC regulated financial services providers,[18] the Singapore MAS,[19] the Hong Kong SFC,[20] the German BaFin[21] and Luxembourg[22] regulated financial service providers. The instruments effecting passport relief were due to expire but have been extended until 1 October 2018.[23] ASIC is currently undergoing review of the passport relief framework and has indicated it will release a consultation paper in early 2018 with its proposals to remake relief.

FFSPs that are unable to satisfy all of the conditions of the passport class orders may rely on individual tailored relief instruments that effectively adopt substantially all of the conditions of a passport class order.

The Commonwealth government has recently released the draft legislation proposing the Asia Region Funds Passport (Passport) and Corporate Collective Investment Vehicle (CCIV) (the Passport Bill).[24] The Passport is a region-wide initiative to facilitate the offer of interests in certain collective investment schemes established in Passport member economies to investors in other Passport member economies. The regime will establish a standardised set of requirements allowing Australian fund managers to offer their products into Asia without

14 ASIC Regulatory Guide 234: Advertising financial products and services (including credit): Good practice guidance, November 2012, RG 234.

15 ASIC, Regulatory Guide 176: Foreign financial services providers, June 2012, RG 176.1-3.

16 ASIC, Regulatory Guide 176: Foreign financial services providers, June 2012, RG 176.88.

17 ASIC Class Order [CO 03/1099].

18 ASIC Class Order [CO 03/1100]; Class Order [CO 04/829]; Class Order [CO 03/1101].

19 ASIC Class Order [CO 03/1102].

20 ASIC Class Order [CO 03/1103].

21 ASIC Class Order [CO 04/1313].

22 21 ASIC Corporations (CSSF-Regulated Financial Services Providers) Instrument 2016/1109.

23 ASIC Corporations (Repeal and Transitional) Instrument 2016/396.

24 Corporations Amendment (Asia Region Funds Passport) Bill 2017.

having to go through duplicate approval processes, while also providing overseas investors access to broader and more diverse fund offerings while maintaining investor protection. The government is currently receiving submissions on the exposure draft of the Passport Bill that is due to close in March. Expressions of interest are currently being sought to participate in a pilot programme to test the various processes of the regime.

Australian presence

Foreign companies wishing to carry on business in Australia, including in fintech, must either establish a local presence (i.e., register with ASIC and create a branch) or incorporate a subsidiary. Generally, the greater the level of system, repetition or continuity associated with an entity's business activities in Australia, the greater the likelihood registration will be required. Generally, a company obtaining an AFSL will be carrying on a business in Australia and will trigger the requirement.

Marketing foreign financial services

Generally, an offshore provider can address requests for information, pitch and issue products to an Australian investor if the investor makes the first approach (i.e., there has been no conduct designed to induce the investor, or that could have been taken to have that effect) and the service is provided from outside Australia.

If the unsolicited approach relates to credit activities that are regulated under the National Consumer Credit Protection Act (the National Credit Act),[25] the provider is required to hold an ACL irrespective of the unsolicited approach.

Foreign exchange and currency-control restrictions

Australia does not have foreign exchange or currency-control restrictions on the flow of currency into or out of the country. However, there are cash-reporting obligations to AUSTRAC.[26] To control tax evasion, money laundering and organised crime, AUSTRAC must receive reports of transfers of A$10,000 or more (or the foreign currency equivalent) and reports of suspicious transactions from reporting entities such as banks, building societies and credit unions.[27] Unless an exemption applies, reporting entities must also submit an AML/CTF compliance report to AUSTRAC, which collects information about the appropriateness of a reporting entity's money laundering and terrorism financing risk assessments and of its AML/CTF compliance programme.

III DIGITAL IDENTITY AND ONBOARDING

There is no generally recognised digital identity in Australia. However, following a request for information from the industry on its alpha design phase, the Australian federal government's Digital Transformation Agency (DTA) is currently in the beta stage of developing a centralised digital identity platform after deciding to create the technology in-house. The national digital identity technology is called 'GovPass' and is intended to be used with government services with an opportunity for future integration with the private sector. A core component of

25 National Consumer Credit Protection Act 2009 (Cth).

26 Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth).

27 Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth) ss 41 and 43.

the GovPass digital identity platform is the identity exchange. The identity exchange acts as an intermediary and sits between the government service and the identity provider. The exchange uses a 'double-blind' to ensure that the relying party, in most instances the government service, receives an identity assurance that has been verified, without revealing the source of the assertion.[28]

At this stage in the development of the platform, the extent to which a GovPass digital identity may be used for transactions beyond government services is unknown. The national identity system will be available to Australian residents who can produce their official identity documents. GovPass is in beta testing with the Australian Taxation Office, with a full launch of the platform predicted in late 2018.

There is currently one other digital identity service in use in Australia. In mid-2017 Australia Post launched its digital identity service 'Digital iD'.[29] The smartphone-based platform is being used by Australia Post and early adopter organisations, including Airtasker, Travelex and Queensland Police. Last year the DTA partnered with Australia Post, working towards the incorporation of Australia Post's Digital iD as one of the identity providers on the federal government's GovPass platform. The government has indicated it plans to collaborate with both other government departments and private-sector organisations to further develop GovPass.

Financial service providers are able to carry out fully digitised onboarding of clients, conditional on 'know your customer' (KYC) and AML/CTF obligations being complied with. Under the Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1) (AML/CTF Rules), electronic verification of client information and data may be used in absence of or together with hard-copy documentation. Financial service providers can use electronic verification to verify the identity of customers who are natural persons where the reporting entity determines that the relationship with the customer is of medium or lower money laundering or terrorism risk.[30]

Entities required to report to AUSTRAC who want to use electronic verification must verify the client's name and residential address using reliable and independent electronic data from at least two separate data sources and either the client's date of birth or the client's transaction history for at least the past three years.[31] Financial service providers must also receive express and informed client consent to use electronic verification.[32] Reporting entities are required to retain information about verification requests and assessments for seven years from the date of the request and seven years after ceasing to provide the designated services to a client.

28 'Initial Privacy Impact Assessment for the Trusted Digital Identity Framework' (Commonwealth Digital Transformation Agency, 2016), https://www.dta.gov.au/files/DTA_TDIF_Alpha_Initial_PIA.pdf.

29 'New national digital identity standards' (Australian Government Digital Transformation Agency, 2017), https://www.dta.gov.au/news/digital-identity-standards/.

30 Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth).

31 Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth).

32 'Guidance note 11/02 – Verification of identity' (Australian Transaction Reports and Analysis Centre, 2011), www.austrac.gov.au/sites/default/files/gn1102-identity-verification.pdf.

IV DIGITAL MARKETS, FUNDING AND PAYMENT SERVICES

i Collective investment schemes

Collective investment schemes in Australia can be managed investment schemes (MIS) (which can be contract-based schemes, unincorporated vehicles (typically structured as unit trusts or unincorporated limited partnerships) or bodies corporate (which are incorporated and typically structured as companies or incorporated limited partnerships).

Depending on the structure, a platform or scheme operated by a fintech company may fall within the scope of the Australian collective investment scheme regulations. They may also be subject to AFSL, ACL, consumer law and financial services laws relating to consumer protection under the ASIC Act.

ii Crowdfunding

Crowdfunding recently became a permitted form of financing in Australia. See Section VIII for more detail.

iii Marketplace lending

Providers of marketplace lending products, including those providing peer-to-peer lending services, generally need to hold an AFSL and comply with the relevant requirements outlined in the Corporations Act including appropriate disclosure and resourcing requirements.

Where the loans are consumer loans (i.e., loans to individuals for domestic, personal or household purposes), the provider will also generally need to apply for an ACL and comply with both the National Credit Act and the National Credit Code contained within the National Credit Act. For all loans – regardless of whether they are consumer loans or not – the consumer protection provisions in the ASIC Act apply. Peer-to-peer lenders are generally structured as managed investment schemes, which must be registered with ASIC if the investment is offered to retail investors.

At the date of writing, there is no secondary market for trading such loans or financings.

iv Payment services

Payment services may be regulated as financial services where such service relates to a deposit-taking facility made available by an authorised deposit-taking institution in the course of carrying on a banking business; or a facility through which a person makes a NCP. In these circumstances, the service provider must hold an AFSL or be exempt from the requirement to do so. ASIC has outlined a number of exceptions including general exemptions in relation to specific NCP products such as gift vouchers and loyalty schemes.

v Data sharing

Currently, the Australian Privacy Principles (APP) dictate when APP entities may use or disclose personal information. They may do so where an individual could expect for the data to be shared or where an exception applies.

In Australia, there has been significant change proposed in relation to how customer data is shared with third parties across every sector of the Australian economy. In February 2018, the Australian Treasury released the review into open banking, which is an application of the comprehensive 'consumer data right' to the banking industry. The new open banking

regime would provide customers with greater access and control over their banking data, including the ability to direct banks to share product and customer data with customers and other third parties.

V CRYPTOCURRENCIES AND ICOS

i Blockchain

There are currently no specific regulations dealing with blockchain technology in Australia. However, in March 2017, ASIC released guidance outlining its approach to the regulatory issues[33] that may arise through the implementation of blockchain technology and DLT solutions more generally. ASIC reaffirmed their 'technology neutral' stance in applying the financial services regime and the notion that businesses considering operating market infrastructure or providing financial or consumer credit services using DLT will still be subject to the compliance requirements that currently exist under the applicable licences.

ii Cryptocurrencies

In September 2017, ASIC released guidance to inform businesses of their approach to the legal status of coins (or tokens) offered through ICOs in Australia.[34] The legal status of such coins is dependent on how the ICO is structured and the rights attached to the coins. Depending on the circumstances, ICOs may be considered to be managed investment schemes, an offer of securities or an offer of derivatives. In these instances, entities offering such coins will need to comply with the regulatory requirements under the Corporations Act. An entity that facilitates payments by cryptocurrencies may also be required to hold an AFSL. Cryptocurrencies are subject to the general consumer protection provisions, whereby providers must not make false or misleading representations or engage in unconscionable conduct.

The Australian government recently passed the Anti-Money Laundering and Counter-Terrorism Financing Amendment Act 2017, which will bring cryptocurrencies and tokens within the scope of Australia's anti-money laundering regime.[35] These amendments are focused on the point of intersection between cryptocurrencies and the regulated financial sector, namely digital currency exchanges and came into force on 3 April 2018. Digital currency exchange providers will now be required to register with AUSTRAC in order to operate. Registered exchanges will be required to implement KYC processes to adequately verify the identity of their customers, with ongoing obligations to monitor and report suspicious and large transactions. Exchanges will also be required to keep certain records relating to customer identification and transactions for up to seven years. The offence for operating a registrable digital currency exchange service without registering with AUSTRAC will carry a penalty of up to two years' imprisonment or a fine of up to A$105,000, or both.

The Australian Taxation Office views cryptocurrencies, similar to Bitcoin, as neither money nor a foreign currency. However, under Australian tax laws such cryptocurrencies

33 Australian Securities and Investments Commission, 'INFO219: Evaluating distributed ledger technology', March 2017, http://asic.gov.au/regulatory-resources/digital-transformation/evaluating-distributed-ledger-technology/.

34 Australian Securities and Investments Commission, 'INFO225: Initial coin offerings', September 2017, http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/.

35 Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth).

are considered assets that can contribute to income and be subject to capital gains tax if held for investment purposes or disposed of for more than A$10,000. In 2017, the Australian government amended the goods and services tax (GST) Act[36] to the effect that the usual 10 per cent taxation on supplies of goods and services no longer applies to the purchase of cryptocurrencies. This GST exemption does not apply to businesses that receive cryptocurrency in return for their goods and services. Entities that are in the business of mining cryptocurrencies or carrying on a cryptocurrency exchange service will need to declare income derived from these activities, as it will be included in their assessable income for taxation purposes.

VI OTHER NEW BUSINESS MODELS

i Smart contracts

Self-executing contracts or 'smart contracts' are permitted in Australia under the Electronic Transactions Act 1999 (Cth) (ETA) and the equivalent Australian state and territory legislation. The ETA provides a legal framework to enable electronic commerce to operate in the same way as paper-based transactions. Under the ETA, self-executing contracts are permitted in Australia, provided they meet all traditional elements of a legal contract: intention to create legally binding obligations, offer and acceptance, certainty and consideration.

Any attempt at an analysis of correction mechanisms, such as arbitration and mediation, in regard to this type of contract, is challenging due to non-existent case law on smart contracts in Australia. Self-executing contracts may alter traditional dispute resolution in Australia based on the possibility of self-executing dispute resolution through online dispute resolution platforms.

ii Automated investments

Generally, fully automated investments are permitted in Australia on the condition that the automated service provider holds an AFSL, or is an authorised representative of a holder of an AFSL, with managed discretionary account (MDA) authorisation.[37] Automated service providers and their retail clients are required to enter into MDA contracts to engage in this process. An MDA contract allows trades to be completed on a client's behalf and includes the ability to automatically adjust the asset allocation of a client's portfolio, without prior reference to the client for each individual transaction. Automated investment service providers must also comply with any conduct and disclosure obligations applicable to providing the automated financial service.[38]

iii Third-party websites

Third-party comparison websites that allow consumers to compare quotes on financial products must be licensed or authorised to provide financial service advice under Australian

36 A New Tax System (Goods and Services Tax) Act 1999 (Cth).

37 'Regulatory Guide 255 – Providing digital financial product advice to retail clients' (Australian Securities and Investments Commission, 2016), http://download.asic.gov.au/media/3994496/rg255-published-30-august-2016.pdf.

38 'Regulatory Guide 175 – Licensing: Financial product advertisers – conduct and disclosure' (Australian Securities and Investments Commission, 2017), http://download.asic.gov.au/media/4543983/rg175-published-14-november-2017.pdf.

consumer protection laws. ASIC requires that third-party comparison websites that rank or award finance products must clearly disclose the basis for providing the rating to ensure consumers are not misled.[39] Disclosure is also required if third-party websites have a link to the providers of the products that are being compared or if not all providers are included in the comparison.[40]

The Australian Competition and Consumer Commission (ACCC), as Australia's competition and consumer law regulator, also has jurisdiction over comparison websites. The ACCC is primarily concerned with the way in which comparison websites drive competition and help consumers make informed decisions. Comparable to ASIC, the ACCC sets out guidance on how third-party comparison websites can facilitate honest comparisons of financial products and services, disclose commercial relationships between comparisons and financial product providers and provide full disclosure of the financial products and providers that are being compared.

iv Other new business models

In mid-2017, Australia welcomed its first 'neobank' project called 'Xinja', a proposed wholly digital quasi-bank that intends to provide full banking services to customers via a solely mobile platform. The term 'neobank' is largely a fluid construct, but will use an internet or mobile platform to interact with customers and offer a different user experience from a traditional bank. For example, the ability to make mobile deposits, person-to-person payments using email addresses or phone numbers, real-time digital notifications of receipts, no monthly fees, no automated teller machines (ATM) fees and intuitive budgeting tools are likely characteristics of a neobank.

The Australian banking sector is highly regulated with stringent licensing and reporting requirements. Consequently, neobanks face significant regulatory challenges in regard to entering the market. Under Australia's current regulatory framework, the Australian Prudential Regulation Authority (APRA) prohibits authorised deposit-taking institutions, with less than A$50 million in capital, from using the word 'bank'.[41] A A$50-million capital threshold is particularly onerous for new entrants, such as neobanks, into the Australian banking system. This is unlike comparable jurisdictions such as the United Kingdom, which has a significantly smaller A$2-million capital threshold to entry for start-up banks. Late last year, APRA closed consultation on a restricted ADI licence, which would allow banking sector entrants to operate on a limited basis while progressing to meet the requirements of an ADI licence.

VII INTELLECTUAL PROPERTY AND DATA PROTECTION

The most appropriate forms of intellectual property (IP) protection in Australia for fintech business models and related software are patent and copyright.

39 'Regulatory Guide 234 - Advertising financial products and services (including credit): Good practise guide' (Australian Securities and Investments Commission, 2012), http://download.asic.gov.au/media/1246974/rg234.pdf.

40 'Regulatory Guide 234 - Advertising financial products and services (including credit): Good practise guide' (Australian Securities and Investments Commission, 2012), http://download.asic.gov.au/media/1246974/rg234.pdf.

41 Banking Act 1959 (Cth).

Business schemes and plans are not patentable, nor are abstract business models that happen to involve a new type of corporate structuring to bring about a certain result. However, there are some business methods that are patentable. In order to be patentable, the business method must directly involve a physical device that is used to bring about a useful product.[42] If the method involves the application of technology, this technological aspect must be substantial. The mere presence of technology is not enough to make a business model patentable; there must be some creation of a useful product. Related software may only receive patent protection if it meets the requirements for a manner of manufacture, and is an industrially applicable solution to a technological problem.[43] Simply putting a business method into a computer is not patentable, unless there is an invention in the way that the computer carries out this method.

Fintech businesses may attain copyright protection for the literary work in source code, executable code and data sets of new software. This usually protects the exact code that causes a computer to bring about a certain result; however, whether this can be extended to the look and feel of the software is debatable.

The question of who owns the relevant IP rights in an employer–employee relationship depends on the employment circumstances. Usually, the employer will own the IP rights to the software or business model developed by an employee who was hired for that purpose. However, the creation must be done in the course of employment. If an employee is not hired to develop software or formulate business models, but happens to develop something outside of business hours without using business resources and not in pursuance of any employment purposes, the employer may not be able to claim IP rights over this creation. Notwithstanding any contractual agreements to the alternative, IP rights in software or business models developed by third-party contractors will generally be owned by the individual contractor.

In relation to both employees and contractors, no compensation will be owed beyond the required payment for services rendered.

i Client data

The Privacy Act substantially regulates the use of personal data. The Privacy Act includes 13 (APPs), which create obligations on the collection, use, disclosure, retention and destruction of personal information. The APPs provide that personal information must be de-identified. In 2017, the Australian government announced that it will legislate a consumer data right that will give consumers access to their electricity, banking, phone and internet transactions. The government also announced an inquiry to recommend the best approach to implementing an open banking regime by which consumers could exercise greater access and control over their banking data. This review will begin reporting in 2018.

42 Australian Patent Office, Patent Manual of Practice & Procedure, 2.9.2.7: Computer Implemented Inventions – Schemes and Business Methods.

43 Australian Patent Office, Patent Manual of Practice & Procedure, 2.9.2.7: Computer Implemented Inventions – Schemes and Business Methods.

VIII YEAR IN REVIEW

i ASIC

In a concerted effort to improve the Australian fintech landscape, ASIC has engaged in considerable consultation on a number of areas including its Innovation Hub, marketplace lending, cybersecurity resilience and opening a dialogue on how to expand Australia's regulatory technology (regtech) sector. Within this, ASIC held a regtech 'showcase' to highlight the opportunities in this space, as well as reaffirming its commitment to the establishment of a regtech liaison group to drive growth in regtech projects. The regulator has also been looking to ensure the stability of new technological solutions in the financial sector through its marketplace lending reports, which sought to determine emerging trends and challenges within this relatively new space. ASIC has been increasingly amenable to discussing opportunities to provide greater regulatory flexibility for fintech start-ups, while keeping a watchful eye on the potential success of such initiatives.

ii Cryptocurrencies and ICOs

The use of cryptocurrencies in new business models and raising funds through ICOs has increased exponentially in the past 18 months. In 2017, ASIC released its guidance[44] regarding the potential application of the Corporations Act to ICOs. While the regulator has not placed a hard ban on the use of ICOs to raise funds, it has made it clear that it will carefully scrutinise ICO structures to determine their legality. The government also passed an amendment to the AML/CTF Act that will bring digital currency exchange providers under the remit of AUSTRAC. Additionally, the Treasury Laws Amendment (2017 Measure No. 6) Act 2017 and changes to the GST Regulations last year removed the double taxation of digital currency. The change means that digital currency is now treated like money for GST purposes, making it easier for digital currency business to operate in Australia.

iii Regulatory treatment of DLT

As outlined previously, in March 2017 ASIC released an information sheet to provide guidance for businesses considering operating market infrastructure, or providing financial or consumer credit services using DLT. The guidance reiterated that the current regulatory framework is intended to be 'technology neutral', meaning that it has been designed to apply irrespective of the mode of technology used to provide the relevant regulated service. ASIC outlined six questions that it will likely ask when assessing whether the specific use of DLT would allow businesses to meet their regulatory obligations. These include:

a How will the DLT be used?
b What DLT platform is being used?
c How is the DLT using data?
d How is the DLT run?
e How does the DLT work under the law?
f How does the DLT affect others?

44 INFO 225 – Initial coin offerings (ASIC, September 2017).

iv Crowd-sourced equity funding

Over the course of 2017, the government passed a number of Acts and regulations that provide a regulatory framework for crowd-sourced equity funding in Australia. This enables companies to raise funds from large pools of investors by utilising a licensed crowd-sourced equity funding (CSF) platform instead of listing on a stock exchange. This regime is currently in effect for public companies,[45] and legislation to extend CSF to proprietary companies has been introduced but is yet to come into effect.[46] With the first CSF licences issued at the beginning of 2018, fintech businesses have already started taking advantage of this new form of retail participation in the sector.

In September 2017, the Corporations Amendment (Crowd-sourced Funding) Act 2017 (Cth) came into effect, amending the Corporations Act to provide a regulatory framework for crowd-sourced equity funding in Australia. The new CSF regime will endeavour to reduce the regulatory requirements for public fundraising by extending the framework for public companies to eligible proprietary companies, while maintaining appropriate investor protection measures.

v Banking Royal Commission

In November 2017, the government announced that it would be conducting a Royal Commission into misconduct in the banking, superannuation and financial services industry. This Commission has been tasked with investigating alleged misconduct by Australia's banks and financial services entities. The terms of reference for the Commission include, among other things, investigation into whether any findings relating to misconduct are attributable to the culture and governance practices of the financial services industry, and whether the current laws and regulations adequately identify and address misconduct by financial services entities. It is anticipated that the Royal Commission will cover most banks, insurers, superannuation providers (excluding self-managed funds), wealth managers, Australian financial service licensees, and intermediaries between borrowers and lenders (e.g., mortgage brokers). While the terms of reference are clearly focused on past misconduct at the retail level, the potential impact of this Royal Commission for innovative and disruptive fintech providers is at this stage uncertain. At the very least, the Royal Commission represents a significant shift in the regulation of the financial services industry in the future and fintech businesses would do well to take note.

vi Design and distribution obligations and product intervention powers

In response to the 2015 Financial System Inquiry, the government has released an Exposure Draft of Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017. The Bill proposes to introduce new design and distribution obligations in relation to financial products as well as provide ASIC with temporary product intervention powers where there is a risk of significant consumer detriment. The new arrangements aim to ensure that financial products are targeted to the right people, and where products are inappropriately targeted and sold, empower ASIC to intervene in the distribution of the product to prevent consumer detriment.

45 Corporations Amendment (Crowd-sourced Funding) Act 2017 (Cth).

46 Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017.

This will likely impact on fintech businesses issuing financial products. In particular there are concerns that ASIC's intervention powers might stifle creativity and willingness to produce new financial products. This is due to the fear of reputational damage in creating products that could be excluded from the market or specified segments of the market by ASIC, or result in a consultation process that delays the offering or sale.

IX OUTLOOK AND CONCLUSIONS

There are many regulatory and legislative developments underway in the fintech space and 2018 is set to bring further developments as the industry matures. With landmark announcements such as the ASX's decision to use DLT to manage the clearing and settling of equity transactions and ASIC's investigation into possible uses of regtech, fintech in Australia is likely to be more robust than ever as the sector moves from speculation to development to implementation.

While there have been a number of initiatives and regulatory developments set to promote fintech investment and innovation, the government is committed to increasing consumer protection throughout 2018. This is seen through the commencement of the Banking Royal Commission and a proposed introduction of new design and distribution obligations and product intervention powers. The overall policy objectives of these measures are to bring greater trust to the financial services industry in Australia and it is hoped that they will contribute to growth in fintech adoption.

Appendix 1

ABOUT THE AUTHORS

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