



REGULATORY BARRIERS TO **FINTECH**



Insight from Fintech Firms
on Regulatory Settings
and What Needs to Change

September 2016





Foreword

A flourishing Sydney Fintech sector has the potential to provide a considerable contribution to the future of the Australian economy and become the leader in this field within the APAC region.

We hear a lot about regulations within ASIC but to fully appreciate what the current regulations mean to our startup community we commissioned this evidence-based report with the imperative of hearing directly from the Fintech startups, incubators and accelerators about how they operate within these regulations.

The report notes a number of interesting findings, key amongst them being that responsiveness and engagement from regulators is critical. ASIC's Innovation Hub was praised in helping Fintech startups. However, the support needs to be reinforced and expanded particularly for businesses which operate under alternative jurisdictions of APRA, AUSTRAC, the Privacy Commissioner and the RBA.

The research also found that the Fintech community needs Australia's regulatory approach to be 'best practice' with a clear understanding of how other countries are regulating the Fintech community thereby enhancing the potential for global mobility within the sector. One respondent currently operating out of Hong Kong was keen to move to Sydney but needed the regulatory environment to be compatible to their business.

Positively, Fintech startups generally welcome robust regulation as this promotes consumer confidence although they said the Federal Government needs to move faster to keep pace with new business models. Response times are currently too slow and this is an important issue for Fintechs (and their investors) which need to move fast on accessing the market.

It is also relevant for investors in those Fintech businesses.

The last key finding was the ability of service providers such as auditors, legal and compliance services to be more accommodating to early-stage Fintech startups. This might be through partnership with an incubator or accelerator space, or by "paying it forward" by scaling models for start-ups.

This report intends to re-ignite the conversation about Fintech regulation based on comments from the sector - highlighting the leadership, responsiveness and risk appetite needed to stimulate the growth of Fintech. Sincere thanks to Jon Ireland, Partner at Henry Davis York for leading the study, and to all participants who willingly gave of their time and invaluable experience.

Hon. Warwick Smith AM LLB

Chair, Financial Services Knowledge Hub
Deputy Chair, Committee for Sydney

Introduction

Sydney is Australia's pre-eminent financial services centre. The city has strong representation from the key financial services sub-sectors such as asset management, wealth management, investment and project finance. Sydney is also a hub for Australia's ICT sector and rapidly growing 'Fintech' (Financial Services Technology) industry.

The Committee for Sydney believes that the Fintech sector, as part of the broader financial services industry, has the potential to provide a valuable and significant contribution to the future of the Australian economy and ensure that the country is a leader in knowledge based industries in the Asia-Pacific region. To facilitate the growth and sustainability of the financial services sector, the Committee partnered with the NSW Government in 2014 to establish a Financial Services Knowledge Hub, to promote collaboration and new thinking in the sector.

Fintech has been chosen as a key area of focus for the Financial Services Knowledge Hub. The origins for this study comprise previous research into identifying what conditions, if any, are necessary and sufficient to enable Sydney to compete and thrive at a local, regional and global level. In particular, KPMG's report for the Financial Services Knowledge Hub, *Unlocking the potential: the opportunity for Sydney* (October 2014), acknowledged that "Fintech provides a pathway to position Sydney for the 'digital economy', fostering new business ventures, both in financial services and technology industries, creating benefits from a multiplier effect across NSW and nationally". A recommended action in KPMG's report was to: "Review current regulatory, tax and business

incentives available to the start-up community and target foreign repeat entrepreneurs and attract them to Sydney."

This report has been commissioned by the Committee for Sydney in its role as coordinator of the Financial Services Knowledge Hub and builds on KPMG's research. This report sets out findings and recommendations resulting from a series of interviews and discussions with Fintech start-ups and incubators/accelerators. It assesses current regulatory settings and their impact on the Fintech start-up community with the purpose of identifying what, if any, regulatory impediments are impacting Fintech start-ups. In addition, this report seeks to acknowledge where the current approach to regulation is benefitting the start-up community. A key element of this research was to explore whether the current approach to regulation is impacting Sydney's competitiveness globally.

This report represents the insights, perspectives and opinions compiled as a result of numerous interviews and discussions. The research for this report was undertaken between January and May 2016. After an initial phase of desktop research to identify a cross-section of interviewees and issues, 1-on-1 interviews were conducted with more than 20 Fintech start-ups, incubators/accelerators and senior executives in the Fintech start-up community. Interviewees included firms in robo-advice, peer-to-peer lending, cloud-based solutions, cryptocurrency, crowdfunding, digital trading research and wearable devices. The interviews were complemented by numerous other discussions with financial services institutions, professionals and other industry representatives.

The study was led by Jon Ireland, partner at Henry Davis York, with the support of the HDY Investments and Financial Services team and the Board members of the Financial Services Knowledge Hub.

Key findings & recommendations

Key findings	Recommendations
<p>Access to, responsiveness and engagement from regulators are of critical importance to Fintech start-ups.</p>	<p>The model of engagement demonstrated by ASIC through its Innovation Hub has been praised as a successful initiative in helping Fintech start-ups navigate the financial services regulatory landscape.</p> <p>Fintechs emphasise the importance of timeliness in the review of cases and issuing of licenses. Furthermore support needs to be reinforced with additional resources and expanded, including to ensure regulatory support for business models which operate partly or wholly outside ASIC's jurisdiction e.g. those falling under the remit of APRA, AUSTRAC, the Privacy Commissioner and (potentially) the RBA.</p>
<p>Regulatory arbitrage and global mobility for start-ups presents both an opportunity and a risk for Sydney's Fintech ecosystem.</p>	<p>Australia's regulatory approach in relation to Fintech start-ups need to be "best practice" and set with a clear understanding of how other countries are regulating the Fintech community. The Regulatory Sandbox and increased flexibility for assessment of responsible managers in new areas such as in equity crowd funding, robo-advice and alternative finance will be key.</p> <p>Government needs to create dedicated or adapted legal regimes for new business models which are flexible to accommodate new entrants and allow them to succeed e.g. crowd-funding and peer-to-peer lending. The extended timeframes for introducing new legislation in Australia (as has been seen for crowd-funding) risks us being left behind in a fast moving and globally mobile environment.</p> <p>The work being done by ASIC to create co-operation agreements with the UK's FCA and Singapore's MAS is a positive step, and industry welcomes the creation of further co-operation agreements in key markets such as the US, EU and China.</p>
<p>Fintech start-ups generally welcome robust regulation as a means of promoting consumer confidence and growth. However, they are frustrated with out-of-date laws and a regulatory approach which is not keeping up with new business models.</p>	<p>The Federal Government should support regulators in finding new and different ways (such as sandboxes) to take on balanced "risk-taking" in order to help foster a safe but positive environment for start-ups. ASIC's new sandbox initiative is a step in the right direction but much more work needs to be done.</p> <p>The current ASIC proposal is too narrow in terms of limiting sandbox participants to largely robo-advice providers with excessive restrictions on services and products permitted. We recommend linking the sandbox initiative to the broader legislative agenda to facilitate support for a wider range of initiatives by introduction of new laws. This could be supported with a bi-partisan approach.</p>
<p>Mixed views prevail around the ability of service providers to provide cost-effective and targeted services to suit early-stage Fintech start-ups.</p>	<p>Service providers to the start-up community need to seize the opportunity to "pay it forward" by scaling services and costs to suit new business models.</p> <p>Any government support for incubators and accelerators (as announced by Jobs for NSW, and by the federal government under the Incubator Support Programme) should include facilitation of pro bono and discounted arrangements between service providers and start-ups.</p>

Interview highlights

Access to, responsiveness and engagement from regulators

There was mixed experience among respondents with the levels of current understanding among regulators in relation to the many different Fintech business models. However, several respondents praised ASIC's Innovation Hub, which they have found to be responsive and providing constructive guidance on applicable regulation.

“Our experience with ASIC has been a positive one. We found them to be helpful and engaged, with officers having taken ownership of getting to know and understand our business model.”

CEO, Peer-to-peer lender

One respondent explained that the Innovation Hub had provided a breakthrough for them in terms of enabling them to get comfortable on the appropriate regulatory treatment for their business model.

“We obtained some initial guidance on the regulatory treatment for our business model with compliance assistance obtained through our accelerator programme. That was tested initially with ASIC but then subsequently after meeting with the Innovation Hub representatives we were able to obtain feedback and reasoning to support our decision to move forward.”

COO, Digital trading research provider



Respondents observed the role of fintechs in increasing competition to the benefit of consumers. Signaling an opposing view to most banks, fintech firms are suggesting the interests of financial regulators and policy-makers (including Treasury, ASIC, ACCC and RBA) should be aligned with the development of solutions that offer choice for consumers and a level playing field in the market.

“As long as banks get to own their customer transaction data, the incumbents benefit and consumers ultimately lose out. Only open data APIs [application programming interfaces] will allow us to efficiently use transaction account data and provide our customers with better analysis, information and services. Some banks like NAB are already embracing this, but the regulators need to see the broader benefits of mandating open data APIs.”

CEO, Industry association

Regulatory arbitrage and global mobility: an opportunity and a risk

International developments are being watched closely by Fintech start-ups and there was a perception among some respondents that Australian regulations have not previously adapted as quickly as those overseas. This has resulted in a concern that that Australia may be left behind other established Fintech hubs such as London, Silicon Valley, and New York, as well as emerging centres such as Tel Aviv.

“Australia needs to ensure it follows international best practice in regulation. There is a risk of parochialism in this market and we need to ensure we are being adaptive to a regional play but at the same time supporting the local market.”

Senior executive, Financial services institution

International competitiveness is seen as a political issue, with part of the debate being in relation to regulatory settings. Many of the firms interviewed have international links. Some have already exploited lower barriers to entry or more welcoming and navigable policy settings in other countries in order to launch their business. Laws that rely too heavily on document-centric and outdated rules have been criticised. While ASIC has provided some relief in this context to allow greater numbers of financial services disclosure documents to be delivered electronically, there remains broader uncertainty around how fintech-related financial services should be accommodated. For example, it has been queried whether it continues to be appropriate to rely on managed investment scheme laws to regulate peer-to-peer lenders.

In markets like Singapore the regulator is actively involved in running fintech events and competitions, and in some cases providing financial incentives for startups to relocate to Singapore. Others like the UK and EU are mandating an open data framework on its banks through APIs and other government agencies are actively engaged in supporting digital identity and cloud technologies.

“*The overseas regulator was very good: consultative and engaged. They were very keen to understand and help and wanted to ensure the fit worked well for our business. Also, the Government representatives were very accessible, proactive and meetings were productive. A breath of fresh air compared with Australia.*”

CEO, Crowdfunding platform

Meanwhile, for some respondents already established in overseas locations, regulation and tax settings related to hiring and retaining talent are both active considerations which have the potential to impact on where they may set up or grow their business in the future.

“*We have established our business and are currently operating from Hong Kong for historical reasons. I would like to relocate to Australia but that will partly depend on the local regulatory environment.*”

Founder, Data service provider



Robust regulation is generally welcomed

The role and level of regulation in the Fintech space is a live and complex issue. A number of respondents viewed high levels of regulation as a differentiator to other less robustly regulated markets, and necessary to build consumer trust which in turn supports growth. But there is a need for balance. Several respondents noted that they were working successfully within existing regulatory settings.

“*We welcome and seek a highly regulated environment. However, it is important that regulatory settings are sufficiently flexible to accommodate new business models.*”

CEO, Robo advice provider

“*The Federal Government needs to support ASIC's mandate and encourage ASIC to support start-ups and innovation.*”

Board member, Fintech Accelerator space

Respondents in the Fintech accelerator space commented that regulators need to be given permission to “take on some risk” when considering new models.

In this context the Federal Government's recent budget support for a sandbox initiative and ASIC's consultation on a model for this are key developments. However, a need for clear and workable eligibility criteria and controls were identified in developing this initiative for Australia.

“A key message to Government needs to be to allow regulators to operate by taking on some risk. Sandboxes are one way of doing this but the approach needs to take into account systemic risk and appropriate controls and oversight.”

Founder, Fintech Accelerator

Sandboxes are seen by other respondents as an example of an overseas regulatory initiative which would be of practical benefit.

“If we had our time over again, sandboxes would have been very helpful in the start-up phase.”

Founder, Digital payments provider

Sandboxes were seen as having the potential to promote not only new business models but also regulatory knowledge and development. This would also assist with resolving concerns around the speed at which Fintech start-ups need to move in order to realise market opportunities. ASIC's outline in the recent consultation paper on a regulatory sandbox approach for Australia will hopefully initiate a positive framework for developing new innovation and delivery of financial services through the use of technology in new ways. However, much work will need to be done on the framework to ensure it provides appropriate levels of opportunity as well as positive consumer outcomes. In particular, the period of availability of the exemptions and how businesses will transition to obtaining a financial services licence will need to be considered.

“Response times are currently too slow with the regulatory settings being what they are. This is an important issue for Fintechs which need to move fast on accessing the market. It is also relevant for investors in those Fintech businesses.”

CEO, Bitcoin operator

Ability of service providers to provide cost-effective and targeted services

Mixed feedback was received on access to service providers (e.g. audit, legal and compliance) and flexibility in pricing of their services. An example given was a perceived high cost of performing an AFS licensing audit on a comparatively small business.

“Overall, our audit experience was that it was too hard and too much “to the book”. A sledgehammer to crack a nut. In this industry, we need service providers to scale their services appropriately.”

CEO, Wearable payments provider

Some respondents thought it was a question of commercial bargaining, others thought providers are playing catch-up to the start-up market.

“We haven't had too much difficulty with providers. To an extent it is about ensuring both sides are clear about the service needed and exercising bargaining position.”

COO, Digital trading research provider

Other start-ups cite the role of accelerators and co-working spaces in marshalling pro-bono expertise from service providers, reinforcing the importance of hubs in building market readiness and networks for early stage firms.

“We haven't needed to engage directly with service providers because they have come to us as corporate partners of Stone & Chalk [fintech hub]. I know that we will probably need more detailed advice at some stage, but so far the general information sessions and office hours have saved us thousands of dollars.”

Founder, Loyalty program provider

About

Financial Services Knowledge Hub

The Financial Services Knowledge Hub is one of 5 industry-led **Knowledge Hubs** supported by the NSW Government.

The Financial Services Knowledge Hub, led by an eminent **board** from across the sector, facilitates collaboration between government of all tiers and business to shape policy and help the private sector share best-practice. Sydney's financial services matter to both the state and the nation. The Knowledge Hub is already producing insights and collaborations which will help support continued innovation and success by the financial services sector with the aim not only of maintaining its national impact but also in strengthening its export capacity in the region in the Asia-Pacific.

Henry Davis York

HDY is one of Australia's leading independent law firms, advising a range of clients including some of Australia's most iconic businesses, regulatory bodies and government departments and agencies, national and international fund managers and property developers. Founded in 1893, HDY has over 40 partners and 300 staff in Sydney, Brisbane and Canberra.

HDY's Investments and Financial Services practice provides corporate, commercial and regulatory advice in a fast-moving regulatory environment. Areas of focus include financial services regulation (including Fintech), investment funds, financial markets and derivatives, superannuation, insurance advisory, funds M&A, investment distribution and regulatory enforcement.

The Committee for Sydney

The Committee for Sydney is an independent think tank and champion for the whole of Sydney, providing thought leadership beyond the electoral cycle. The Committee aims to enhance the economic, social, cultural and environmental conditions that make Sydney a competitive, resilient and liveable global city.

The Committee has a diverse membership with over 100 member organisations: including the major corporate sectors driving Sydney's economy; strategically minded local authorities; key NSW Government departments and agencies; not-for-profit organisations; and leading arts and sporting institutions. Members help develop and deliver priorities, provide expertise and ensure a representative geographical spread across the greater Sydney region.

The Committee for Sydney

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