

3 November 2017

Shellie Davis
Senior Adviser, Financial System Division
The Treasury
By email: sandbox@treasury.gov.au

Dear Shellie,

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

CHOICE, Consumer Action and Financial Rights Legal Centre appreciate the opportunity to comment on the Treasury Laws Amendment (Measures for a later sitting) Bill 2017: FinTech Sandbox Regulatory Licensing Exemptions (the legislation) and associated documents.

While we support the intent of encouraging competition to create new services for consumers we are extremely concerned about the risks that this approach involves. The legislation would allow, for example, unlicensed financial advice on superannuation products, insurance and long-term investments. These services are too complex and too important to the long-term well-being of consumers to be offered without the adequate protections that the sandbox removes. Rather than watering down consumer protections, the financial industry needs much higher standards to prevent the scandals that have drained consumer savings and investments.

We note that the Explanatory Memorandum states that the legislation seeks to “strike a better balance between encouraging competition and innovation that delivers choice for consumers and minimising risks to consumers or the integrity of the financial system.”¹ The premise that competition and consumer protection must be balanced or traded against one another is misguided. As noted in Australia’s competition legislation and in recent reviews of competition settings, competition is a means to achieve good consumer outcomes and not an end in itself.

Innovation can produce significant benefits for consumers. However, not every product innovation is necessarily in consumers’ best interests. This is particularly the case in complex markets such as financial services, where the risks of bad product design and misselling can have catastrophic consequences. For example, we have recently seen “innovation” from payday lenders which has led to more online targeting and quick loan applications for high-cost debt.

Similarly, we’ve seen “innovation” in the superannuation sector with new entrants offering relatively high-cost options to consumers that are sold in a highly-targeted manner online. New funds, such as Future Super, market on providing values alignment with members by investing in ethical, green, sustainable and tech related options. However, fees on these new products are well above the industry average, which according to Rice Warner is 1.03%.² For example, Future Super has fees of almost 2% on a balance of

¹ Explanatory Memorandum, p.7.

² <http://www.ricewarner.com/superannuation-fees-how-low-can-we-go/>

\$50,000³, by comparison Australian Super’s default option fees are 0.796%⁴. This large difference in fees can have a catastrophic impact on a member’s retirement balance. As the standard disclosure on a superannuation product disclosure states, total annual fees and costs of 2% of an account balance rather than 1% could reduce a final return by up to 20% over a 30 year period (for example, reduce it from \$100,000 to \$80,000). The picture is no better when considering investment return objectives. For example, Future Super aims to outperform the Consumer Price Index (CPI) by +2.5%,⁵ this pales in comparison to the return target of CPI +3.85% for Australian Super’s MySuper product.⁶ Despite the extremely high fees and lacklustre return targets, it is clear these “innovators” are proving popular with some consumers. Another fund, Spaceship, announced it had over \$100 million under management just months after launch.⁷

We need to ensure that innovation leads to services that genuinely meet the needs of Australian consumers rather than simply selling a toxic product in a more effective way.

Recently, small and large financial service providers have demonstrated appallingly low regard for consumer needs and protections. CHOICE is concerned that providers invoking a halo of ‘innovation’ may fall through gaps consumer protection requirements. For this reason, we believe stronger protections for the sandbox are required.

The sandbox puts consumers and the fintech industry’s reputation at risk

There are risks to ASIC’s existing regulatory sandbox and the proposed expansion in the legislation. Both initiatives allow any business that meets criteria to use the regulatory exemption. In comparison, other sandbox initiatives involve an assessment of whether services are innovative and good for consumers before a regulatory exemption is granted.

	United Kingdom	Singapore	Hong Kong	Australia
How do businesses enter the sandbox?	Applicants must apply to the regulator (FCA) for regulatory exemptions. ⁸	Applicants must apply to the regulator (MAS) for regulatory exemptions. ⁹	Applicants must apply to the regulator (HKMA) for regulatory exemptions. ¹⁰	No assessment, businesses instead notify ASIC that they will be selling a product unlicensed.
What are the evaluation criteria?	Only applicants that are genuinely innovative, aimed at the UK market, will benefit consumers and are	Applicants should use new or emerging technology, should show that there are few or no comparable services in Singapore,	Applicants must demonstrate a clear boundary for their sandbox test, that there are adequate consumer protections	Any business that has insurance and is a member of an EDR scheme can enter. There is no consideration of

³ Future Super fees on a balance of \$50,000 are \$988.60: https://content.myfuturesuper.com.au/forms-docs/FS_PDS.pdf?_ga=2.40444450.1201986051.1509589942-227657068.1509589942

⁴ Australian Super MySuper product, assumption based on a balance of \$50,000: <https://www.australiansuper.com/superannuation/why-choose-australiansuper/fees-and-costs.aspx>

⁵ Future Super, 2017, ‘Product Disclosure Statement’, p.4, available at: https://content.myfuturesuper.com.au/forms-docs/FS_PDS.pdf?_ga=2.236748801.1220893838.1504149591-960514643.1490672366

⁶ Australian Super, 2017, ‘MySuper Dashboard’, available at: https://www.australiansuper.com/~/_media/Files/MySuper%20dashboard/FS%20ProductDashboard.ashx

⁷ <http://www.afr.com/technology/inside-the-multibillion-dollar-battle-for-millennials-super-20170606-gw191y>

⁸ <https://www.fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox>

⁹ <http://www.mas.gov.sg/Singapore-Financial-Centre/Smart-Financial-Centre/FinTech-Regulatory-Sandbox.aspx>

¹⁰ <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2016/20160906e1.pdf>

	ready for testing are accepted.	address a problem or bring benefits to consumers or an industry, define the test, assess risks and demonstrate an exit or transition strategy.	for the trial, that there are risk management controls and that systems and processes are ready for trial.	whether a business is innovative, useful to Australia, has the right consumer protections for an experimental test or is ready to test.
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The model chosen for Australia increases the risk that businesses that aren't willing or able to comply with the law will begin to sell services to consumers. For example, financial advice services will not need to meet all regulatory requirements tied to licensing that ensure consumer protections. Under the existing ASIC sandbox arrangements and the new Treasury proposal, any new advice businesses wanting a regulatory exemption will be exempt from requirements to prove that they:

- Have adequate arrangements in place to manage conflicts of interest.
- Take reasonable steps to ensure that people working for the company comply with financial services law.
- Maintain the competence to provide the financial services.
- Adequately train the people working for the company to ensure they are competent to provide the financial service.
- Have adequate risk management systems.¹¹

We believe it is likely that the sandbox regulatory exemption will be used by some unscrupulous parties to sell products that are harmful to consumers. This is a risk to consumers and the fintech industry's reputation.

Proposed legislation limits ASIC's ability to intervene

The legislation allows for ASIC to intervene if services in the sandbox fail to meet license conditions. Specifically, "If an entity fails to meet any of the prescribed conditions, ASIC may cancel an entities' exemption or apply to the court for an order requiring the entity to comply in a particular way."¹²

Given that there will be no proactive examination of sandbox services, this protection is too limiting and inadequate. It also prevents ASIC from taking targeted action – the regulator's options are to cancel all activity or go through a lengthy court process. In some cases, it is likely that only small changes are needed, for example, better disclosure or a small change to a service rather than removal of the product from the market. ASIC needs better powers to act quickly and in a targeted way should something an experimental sandbox service be causing consumer harm.

Product Intervention Powers – a targeted solution

Our first preference to address these risks would be for ASIC to assess applicants before they're granted a regulatory exemption or entry into the sandbox, similar to the approach used in the UK, Singapore and

¹¹ These are all current requirements of AFSL holders providing financial advice. These obligations are set out in ASIC (2016) Regulatory Guide 36: Licensing: Financial Product Advice and Dealing, page 32-33. <http://download.asic.gov.au/media/3889417/rg36-published-8-june-2016.pdf>

¹² Explanatory memorandum, p. 8.

Hong Kong. However, we recognise that the Federal Government is looking to distinguish Australia from other countries in the support it provides to the fintech sector.

As an alternative, the Treasury should give ASIC the power to act if they find sandbox participants are offering harmful products or services. ASIC's current powers typically only allow the regulator to intervene after something has gone wrong, with few protections to stop the sale of objectively poor value products or products that are poorly designed or sold to an audience that will be harmed by that sale. Treasury is consulting on the detail of new Product Intervention Powers (PIP) for ASIC but it's unclear when PIP will be finalised.

A sandbox-specific PIP should allow ASIC to act quickly if harmful products or services are sold. This should allow ASIC to impose additional disclosure obligations, mandate warning statements, require amendments to advertising, or in extreme cases restrict or ban the distribution of any product or service in the sandbox.

A sandbox-specific PIP has the benefit of imposing no additional obligation on sandbox participants unless ASIC detects a problem while also reducing the risk of consumer harm and damage to the fintech industry's reputation. It would require additional resources so that ASIC could monitor activities in the sandbox as it is used by more parties.

Recommendations:

- That ASIC assess applicants before they're granted a regulatory exemption or entry into the sandbox, ensuring that sandbox participants are genuinely innovative, will benefit consumers and are ready for testing.
- If this cannot be achieved then the enhanced regulatory sandbox legislation should give ASIC new product intervention powers to act against products or services that are misleading or harmful to consumers.

Please contact eturner@choice.com.au with any questions about this submission.

Kind regards,



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