

W5 Post-Global Financial Crisis Regulation of Banking in Australia: Reforms and Emerging Challenges (II)

What is Fintech? How does the Australia government regulate Fintech (e.g., Fintech licensing exemption- general requirements)?

What is "Fintech"? How does it evolve?

Financial technology (Fintech) describes an emerging financial services sector in the 21st century. Originally, the term applied to technology applied to the back-end of established consumer and trade financial institutions. Since the end of the first decade of the 21st century, the term has expanded to include any technological innovation in the financial sector, including innovations in financial literacy and education, retail banking, investment and even crypto-currencies like bitcoin.

The term financial technology can apply to any innovation in how people transact business, from the invention of digital money to double-entry bookkeeping. Since the internet revolution and the mobile internet revolution, however, financial technology has grown explosively, and fintech, which originally referred to computer technology applied to the back office of banks or trading firms, now describes a broad variety of technological interventions into personal and commercial finance. ASIC has released a world-first class waiver to allow eligible fintech businesses to test certain specified services for up to 12 months without an Australian financial services or credit licence.

Fintech general requirements

For financial services, an Australian financial services (AFS) license is generally required; alternatively, providing financial services on behalf of an AFS licensee as a representative. Financial services generally provide financial product advice; deal in a financial product; make a market for a financial product; operate a registered managed investment scheme; provide a custodial/depository service; or provide traditional trustee company services. For consumer credit, an Australian credit license is generally required; alternatively, acting as a representative of a credit licensee. There are two broader categories of credit activities, including credit activities relating to the provision of a credit contract or consumer lease and securing obligation thereunder; or assisting persons to enter into a credit contract.

Fintech Licensing Exemption

Australia's regulatory sandbox framework is comprised of three broad options for testing a new product or service without a licence. Those options include relying on existing statutory exemptions or flexibility in the law, such as by acting on behalf of an existing licensee; relying on ASIC's 'fintech licensing exemption' for the testing of certain specified products and services; and for other services, relying on individual relief from ASIC.

The aim of the fintech licensing exemption is to facilitate innovation in financial services and credit by allowing businesses to test certain product and service offerings without holding a license for a testing period of 12 months (RG257.45).

Overview of the exemption

There is no need to apply (i.e. fill out a physical form) to obtain the benefit of this exemption. As long as the business satisfy the requirements in the exemptions, they are legally entitled to *rely* on this exemption for 12 months (RG257.41). However, businesses wishing to apply for the exemption must notify before starting relying on this exemption and provide certain information, business can commence after 14 days (RG257.42). It is also important to note that it is prohibited to suggest to consumers that your business/business model has been licensed, authorized or approved by the ASIC (RG257.43).

Eligibility

- [RG257.51) Financial Services: The person seeking to provide financial services must not:
 - a) be banned from providing financial services;
 - b) already hold an AFS license;
 - c) already be an authorized representative of an AFS licensee that is authorized to provide the services covered by the exemption; or
 - d) a related body corporate of an AFS licensee (see s 50 of the Corporations Act)
- [RG257.52) Credit Activities: The person seeking to engage in the credit activities must not:
 - a) be banned from engaging in credit activities;
 - b) already hold a credit license;
 - c) already be a credit representative of a credit licensee; or
 - d) be a related body corporate of a credit licensee (see s 50 of the Corporations Act).

What Products and services Can Be Tested?

1. Financial Services [RG 257.56-257.60]

- [RG257.57] The fintech licensing exemption applies to specified services. It does not apply to all financial services or credit activities. It is permitted to provide the following services without holding an AFS license: (a) Giving financial product advice in relation to those listed at RG 257.58, and (b) dealing in the products listed at RG 257.58, other than by issuing those products.
- [RG 257.58] The fintech licensing exemption for advice and dealing (other than acting as a product issuer) applies in relation to:
 - a) Listed or quoted Australian securities;
 - b) Debentures, stocks or bonds issued or proposed to be issued by the Australian Government
 - c) Simple managed investment schemes;
 - d) Deposit products;
 - e) Some kinds of general insurance products; and
 - f) Payment products issued by authorized deposit-taking institutions (ADIs)
- [RG257.59] It is important to note that this exemption is NOT available for issuing financial products.

2. Credit Services [RG 257.61-257.64]

- [RG 257.61] The fintech licensing exemption allows you to provide credit services in relation to certain types of credit contracts without needing to hold a credit licence.
- [RG 257.62] The exemption allows you to act as an intermediary or to provide credit assistance in relation to a credit contract that:
 - a) has a maximum amount of credit of no more than \$25,000;
 - b) has a maximum annual cost rate of 24%;
 - c) is not subject to tailored responsible lending obligations (i.e. is not a reverse mortgage or a small amount credit contract); ; and
 - d) is not a consumer lease
- [RG 257.63] This exemption is NOT available for providing credit.

Providing services that are not covered by the fintech licensing exemption [RG 257.69]

[RG257.70] If you want to provide products and services that are not covered by the fintech licensing exemption, as well as offering services that are covered by the exemption, you can do one of the following:

- a) rely on another exemption, for example, existing flexibility in the laws;
- b) hold an AFS or credit licence with appropriate authorisations covering all of the services you intend to provide; or
- c) obtain individual relief (Section G and RG 51).

Testing period

[RG 257.71] If a business rely on the fintech licensing exemption, they do not need to hold a licence for one 12-month period (testing period). The testing period commences 14 days after the business advise ASIC that they intend to rely on the exemption (unless we take further action). They will be notified in writing of the date on which your testing period commences.

[RG 257.72] ASIC consider 12 months is sufficient time for businesses to be able to test the viability of the business model or idea and, at the same time, begin the process of applying for an AFS or credit licence.

[RG257.73] After the 12-month testing period ends, businesses will need to cease operations unless:

- a) they have been granted an AFS or credit licence;
- b) they have entered into an arrangement to provide services on behalf of an AFS or credit licensee (see RG 257.26–RG 257.28); or
- c) ASIC have given individual relief extending the testing period.

[RG257.74] After the end of the testing period, you will no longer be able to offer financial services or engage in credit activities unless you comply with the law like other businesses. This includes financial services or credit activities you provide to your current clients.

General Conditions

- [RG257.82] Have no more than 100 retail clients (no limit wholesale): The fintech licensing exemption is subject to a limit on the number of retail clients that a testing business can engage and the exposure of each client. Testing businesses relying on the exemption can provide services to up to 100 retail clients.
- Plan to test for no more than 12 months and meet disclosure and conduct requirements
- [RG257.83] Have total customer exposure of no more than \$5 million (see also individual exposure for retail investors).
- [RG257.96] Have adequate compensation arrangements (e.g., professional indemnity insurance);
- [RG257.103] Have dispute resolution processes in place;

What if the business need more time or other flexibility?

ASIC will accept and consider applications for:

- an extension to the testing period (e.g. to allow you to test your services for an additional 12 mths);
- an increase in the client limits (e.g. to allow you to provide services to up to 200 retail clients); or
- variations to other conditions of the relief.

[RG 257.129] Factors for extending the testing period or increasing the client limits are:

- a) the nature of the extension or variation you are seeking;
- b) the reasons you are seeking an extension to the testing period or an increase in the client limits;
- c) how the extension you seek (e.g. additional testing time or testing with additional clients) will allow you to validate your business model, and not just extend the scope of your operations;
- d) the date at which your testing period began;
- e) whether you have applied for a licence and, if so, the date on which you submitted your application; and
- f) your experience to date in providing services during your testing period, including whether there have been any material disputes with consumers or reports of misconduct to ASIC; and
- g) the normal matters we consider when deciding whether or not to grant an exemption—these are outlined at RG 51.57–RG 51.62.

Extra Content (ASIC Innovation Hub, Foreign clients, UK Approach in Fintech, Fintech & GFC implications)

ASIC Innovation Hub

Innovation hub is an ASIC initiative for new fintech businesses that are developing innovative financial products or services. Via the Hub, eligible fintech start-ups receive informal assistance to navigate the regulatory system. Assistance offered is not legal or financial assistance. They are informal guidance during the pre-license application phase, for instance, the obligations under the financial services regulatory framework, how the ASIC administers this framework (e.g., how to obtain a license). Business that is eligible to use the services of Innovation Hub include a financial technology (Fintech) business; has not been trading under a license from ASIC for over 12 months; offers a potentially groundbreaking innovation; and offers an innovation that provides a potentially better outcome for investors and consumers.

Are foreign clients counted in the 100 retail cap?

ASIC expect where the service provider provides services to foreign retail clients or foreign consumers in the course of its Australian financial services business or credit services business, those clients or consumers would generally need to be included in the 100 retail clients or 100 consumers cap.

Can business refer publicly to assistance ASIC provides through the Innovation Hub?

ASIC does not object to you mentioning that we have provided informal assistance to you via the Hub. However, you should not create an impression (explicitly or implicitly) that your business or services are in any way endorsed or approved by ASIC and you must not reproduce ASIC's logo without our express approval.

What do I need to tell consumers about my reliance on the sandbox exemption and not being licensed?

- Under the fintech licensing exemption, you will need to comply with key consumer protection provisions in the financial services and credit laws: [RG 257.86 -87].
- You will also need to tell your clients that [RG 257.88]
 - you do NOT hold a license;
 - the service you will provide is being tested under the fintech licensing exemption; and
 - some of the normal protections associated with receiving services from a licensee will not apply.

UK Approach in Fintech

The regulator of UK is the Financial Conduct Authority (FCA). It is required to apply for participation in the regulatory sandbox to get authorization in order to test. The general criteria are:

- **Scope:** Are you looking to deliver innovation that is either regulated business or supports regulated business in the UK financial services market?
- **Genuine Innovation:** Is your innovation ground-breaking or a significantly different offering in the marketplace?
- **Consumer Benefit:** Does the innovation offer a good prospect of identifiable benefit to consumers (either directly or via heightened competition)?
- **Need for a Sandbox:** Do you have a genuine need to test the innovation in our sandbox? Applicants aren't required to need a sandbox tool to meet these criteria
- **Ready for Testing:** Are you ready to test the innovation in the real market with real consumers? Any authorization or registration will be restricted to allow firms to test only their ideas as agreed with us.

The FCA ensures that firms have appropriate customer safeguards in place, and agree on a case-by-case basis within the below standards:

- **Retail consumers** –this type of customer should not bear the risks of sandbox testing; thus, they should always have the right to complain to the firm, then to the Financial Ombudsman Service and have access to the Financial Services Compensation Scheme if a firm fails;
- **Sophisticated customers** –depending on the specifics of the trial, and if legally possible, we could consider tests that only engage with sophisticated customers who have consented to limiting their claim for compensation ('informed consent');
- **Additional safeguards** –depending on the size, scale and risks from the trial, additional safeguards may be necessary, e.g. disclosure about being involved in a sandbox test to retail consumers. FCA, Default Standards for Sandbox Testing Parameters; Lev Bromberg, Andrew Godwin, and Ian Ramsey, "Fintech Sandboxes: Achieving a Balance Between Regulations and Innovation."

What are the implications of the GFC for the Fintech?

As the financial services industry evolves, competition in the financial industry also increased. Fintech has stem not only from mainstream asset classes and markets but from non-traditional fintech propositions due to its flexibilities. Developments in crowd funding, robo-advice, big data analytics, algorithms, peer-to-peer based platforms and virtual currencies among others are set to evolve as well as seek to gain market share.

What are benefits and risks associated with Fintech?

[Benefits] Fintech has opened the world to a wide variety of possibilities. Businesses can now provide better and additional services and facilities to customers. The services offered come at much more reasonable costs. It has improved ways in which you can transport money across borders. It enhances the processes of mobile payments and promotes crowdsourcing, by which like-minded people can pitch their ideas to the world.

[Risks] 1) Operational risks from third-party service providers: Existing oversight frameworks for important third-party service providers (for example cloud computing and data services) to financial institutions may need to be enhanced, in particular where financial institutions rely on the same third-party service providers. 2) Cross-border legal issues and regulatory arrangements. Innovations in cross-border lending, trading and payment transactions raise questions about the cross-jurisdictional compatibility of national legal frameworks. The legal validity and enforceability of smart contracts and other applications of distributed ledger technology are in some cases uncertain.

Regulatory framework of data protection in Australia (e.g., Privacy Act; Australian Privacy Principles)

Commonwealth has introduced a few legislations for data protection, including the Privacy Act 1988 (Cth) (Australian Privacy Principles (APPs) and Other codes made under the Privacy Act, e.g., the Privacy (Credit Reporting) Code 2014); Do Not Call Register Act 2006 (Cth); The Spam Act 2003 (Cth); and ASIC e-Payment Code. At the State levels regulations such as Privacy and Data Protection Act of 2014 (Vic) is introduced. Among industry/private Sector, for example the banking sector, Code of Banking Practice is in place for consumer data protection. Under Common Law, there are duties of confidentiality arises out of banker-customer relationship.

Privacy Act

1-1 Schedule 1 13 Australian Privacy Principles (APPs) Collection, use, disclosure and management of personal information by private sector organizations and federal public sector organizations. The regulator is the Office of Australian Information Commissioner (OAIC).

- They are legally binding principles, the cornerstone of the privacy protection framework in the Privacy Act. The APPs set out standards, rights and obligations in relation to handling, holding, accessing and correcting personal information
- The APPs apply to “APP entities”: including most Australian Government (and Norfolk Island Government) agencies and private “organizations”—individuals, body corporate, partnership, unincorporated associations, trusts, unless certain exceptions (e.g., small business operator, a registered political party) [Privacy Act s. 6].
- What information is regulated?
 - ...information or an opinion, whether true or not, and whether recorded in a material form or not, about an identified individual, or an individual who is reasonably identifiable [Privacy Act s. 6].
 - e.g., individual’s name, signature, address, telephone number, date of birth, medical records, bank account details and commentary or opinion about a person.
 - Special rules apply to “Sensitive information” (e.g., health information, genetic information, biometric, race, sexual behaviour, criminal records)
 - Financial information about a person is not “sensitive information.”
- Breach of an APP in relation to personal information about an individual is an “interference with the privacy” of the individuals [Privacy Act s.13 (1)]- the individual may file a complaint or the OAIC may investigate on its own [Privacy Act, Pt. V]. The OAIC has a range of enforcement powers and other available remedies.

1-2 Credit Reporting Scheme Part III A of the Privacy Act Collection, use, disclosure and management of certain credit-related personal information, and access to the credit reporting system, by credit providers and credit reporting bodies. This part regulates consumer credit reporting in Australia.

- It is supplemented by:
 - PrivacyRegulation2013;and
 - The Privacy (Credit Reporting) Code 2014: The code obligations are binding—a breach of the code is a breach of the Privacy Act.
- Purpose: To balance protecting your personal information with the need for credit providers to have enough information to help them decide whether to give you a loan.
- Key aspects
 - Circumstances in which a disclosure of credit information to a credit reporting body (CRB) is permitted and notification requirements for collecting personal information that may be disclosed to CRBs;
 - Disclosures relating to the management of credit information and credit eligibility information;
 - How credit eligibility information is to be dealt with by credit providers (CPs), including permitted uses and disclosures of such information;
 - The integrity of credit information and credit eligibility information; and
 - The access to and correction of credit eligibility information.

General Data Protection Regulation (GDPR)

“**Regulation**”- directly applies at individual Member national level and harmonize data protection law across the EU (previously, 95/46 **Directive**). *Effective from May 25, 2018*

An overview of GDPR

Who Does GDPR Apply To?

- data controller (i.e., entities that define the purposes and means of processing) or processors (i.e., those who process personal data on behalf of the controller) with an establishment in the EU, or outside the EU, that offers goods/ services to individuals or monitor the behaviour of individuals in the EU (Art. 3).
- Processing means, among others, collection, use & disclosure.

What Does GDPR Apply to?

- “Personal data”- any information relating to an identified or identifiable natural person and includes data such as an IP address, an email address or telephone number, location data, etc.

Violation: fines of breaches of certain provisions can lead up to € 20 m or 4% of global annual turnover (whichever is greater). *For example*, an online business such as Facebook or Amazon will be subject to GDPR, even if they do not have any branches in Europe, they will be subject to this rule if they provided any product or service to customers in Europe.

Key Elements of GDPR

Basic Principles Relating to Processing (Art. 5)

- Principles of Lawfulness, Fairness, and Transparency: How can you legally collect and process someone's information? With "**consent**"
- Principle of Purpose Limitation
- Principle of Data Minimisation (only if necessary for the purpose)
- Principle of Accountability
- Principles of Storage Limitation and Integrity and Confidentiality

Lawfulness of Processing (Art. 6): one of the following

- **Consent**
- Necessary for the performance of a contract to which the data subject is a party
- Necessary for compliance w/legal obligation to which the controller is subject
- Necessary to protect the vital interests of the data subject or another natural person
- Public interest
- Necessary for the legitimate interests pursued by the controller or by a third party.

Data Subject's Rights (Art. 12-23)

1. Right to Information :Requiring data controller to give individuals certain info re: the processing of their personal info free of charge (exceptions apply: Art. 14) (cf. APP 12.5)
2. Right to Be Forgotten: Individuals have the right to require their data to be removed in certain circumstances (e.g., no longer necessary for the purpose of collecting the data) (no equivalent, but see APP 11.2)
3. Right to Data Portability: Individuals have the right to receive personal data that he/she has provided to the controller in a structured, commonly used and machine readable format so as to transfer to another controller (no APP equivalent)
4. Right to Explanation (touches upon automated individual decision-making, including profiling).
 - a. Example: in the US a couple of years ago there was an outcry of how credit rating agencies collect data
 - b. They base it on certain proxies such as your zip code
 - c. Typically in the US in some areas people are more likely to be a minority group
 - d. This can be seen as a form of discrimination, but we are not aware of that

Some Reflections: Dar side in the age of Big Data?

To counter these kinds of discriminations the US has Acts that will challenge these kinds of procedures

US- Equal Credit Opportunity Act (ECOA)

- Prohibits credit discrimination on the basis of race, colour, religion, national origin, sex, age, martial status, receipt of income from public assistance program. It applies to consumer and commercial credit

In Europe there is a similar regulation:

EU GDPR Art. 22

The data subject shall have the right not to be subject to a decision based solely on automated processing, including profiling, which produces legal effects concerning him or her or similarly significantly affects him or her.

Paragraph 1 shall not apply if the decision:

1. is necessary for entering into, or performance of, a contract between the data subject and a data controller;
2. is authorised by Union or Member State law to which the controller is subject and which also lays down suitable measures to safeguard the data subject's rights and freedoms and legitimate interests; or
3. is based on the data subject's explicit consent.

In Australia there are currently no such provisions