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30 December 2019

Department of the Senate  
PO Box 6100  
Parliament House  
Canberra ACT 2600  
Email: fintech.sen@aph.gov.au

Dear Select Committee on Financial Technology and Regulatory Technology (“**Select Committee**”),

**Re: Financial Technology and Regulatory Technology**

Pepperstone Group Limited (“**Pepperstone**”) welcomes the opportunity to make an additional submission to the Committee on Financial Technology (“**FinTech**”) and Regulatory Technology (“**RegTech**”) to assist the Select Committee with its mandate.

This submission should be read in conjunction with our original submission dated 18 October 2019.

**1. What area of technological innovation does your company specialise in?**

Pepperstone is a global CFD and margin foreign exchange (“**FX**”) contract issuer that was established in 2010 in Melbourne, Australia. We are an online financial services business that has over 68,000 clients and supports an annual client trading turnover of \$3.7 trillion. We currently have over 120 employees in Australia as well as offices in the United Kingdom (“**UK**”), Dubai and Cyprus.

In addition to developing and maintaining trading, risk management, onboarding and other financial services software solutions that are a key part of the financial service we provide, we are also constantly designing and evolving various RegTech solutions in-house. Among other things, Pepperstone’s RegTech solutions assist us to:

- comply with our various regulatory obligations;
- monitor our clients and business practices to ensure we remain within the organisation’s defined risk tolerances; and
- protect the business from fraudulent practices and cybercrime.

As a purely online business we are particularly vulnerable to online fraud and cybercrime and financial services companies outside of the bigger banks and brokers are often seen as potential soft targets that may not have systems as sophisticated or established as those larger firms.

Simply hoping that the firm will not be a target is not an option for Pepperstone. One material data breach event could not only result in regulatory sanctions (from multiple regulators given that Pepperstone is a global business) including millions in dollars in fines but also cause irreparable

reputational damage. Off-the-shelf solutions are available but which are generally extremely costly and often not 'fit for purpose' due to the particularly niche nature of our business offering.

As a result, we have to be innovative in order to adequately protect ourselves, have confidence that we are able to meet our obligations, and provide a safe, stable system for our clients.

## **2. In general terms, how would you describe the operating environment for FinTech and RegTech start-ups in Australia?**

The Australian Government and its agencies have shown that they are keen to support and assist FinTech and RegTech start-ups in Australia, which is a positive baseline requirement to encourage firms to establish themselves in Australia.

As mentioned in our previous response, Australia's principle-based regulatory framework is also a big advantage due to the flexibility it provides to firms that operate within it. We would encourage the Government to promote this as a benefit of operating a RegTech or FinTech business within Australia, and discourage regulators from moving to more prescriptive regulations, where possible.

Clarity around regulatory requirements and how various FinTech products and businesses fit under regulatory obligations could be improved, especially if it is offered in an easy to absorb format.

We believe a key hurdle for FinTech in Australia is the support for firms once they fall outside of the "start-up" category. If firms are subject to high levels of regulatory burden or if regulators choose to severely limit product offerings after firms establish themselves and reach a level of success, then many firms may consider that it is not practical for them to remain in Australia. Unfortunately, these types of negative impacts often occur when firms are in the strongest position to contribute back to Australia and its economy.

We acknowledge that the Select Committee is also examining how to encourage more RegTech uptake in Australia in timeframes shorter than the typical 2 years sales cycle. While we appreciate it can be difficult for RegTech firms to gain traction in Australia, as a consumer of RegTech Pepperstone will often have no choice but to ensure it partners with someone with a clear established record for the following reasons:

- we operate a large volume business that is rapidly evolving, which is often beyond any typical testing that can be undertaken by smaller RegTech firms leading to issues once it is put into operation;
- even if discrepancies or errors are directly caused by the RegTech system, it is the regulated business (i.e. Pepperstone) that is ultimately held responsible by the regulator, so it is incumbent upon that business to ensure that any RegTech system it implements has a clear track record of operating as advertised; and
- regulators can change requirements regularly (for example, every CFD issuer is required to report their client trades to a central repository. After a few years this requirement moved from end of day summarised positions to lifecycle trade reporting of every transaction, which is far more complex). In light of this, regulated businesses like Pepperstone need confidence that the RegTech firms they rely on will be around to implement the necessary improvements in a timely, efficient way.

Unfortunately, Pepperstone is unable to provide an obvious solution to these limitations but looks forward to observing the Select Committee's work going forward to see any solutions it believes are practical to reduce the typical 2 years sales cycle.

**3. What are the biggest opportunities and challenges for your business in the short-to medium term? In particular, you may wish to comment on any of the following issues:**

- **Capital and financing arrangements (including access to venture capital and other forms of finance).**
- **Staffing, recruitment and talent retention.**
- **Collaboration and partnerships with other nascent firms and traditional financial services firms.**
- **Opportunities to expand into overseas markets.**
- **Issues affecting your business that may be specific to your product niche or area of specialisation (rather than affecting the FinTech and RegTech sectors as a whole)**

*3.1 Capital and financing arrangements (including access to venture capital and other forms of finance)*

This is not currently an issue for Pepperstone given the maturity of the business.

As a global business with regulated or soon-to be regulated presences in a number of other regulatory jurisdictions, Pepperstone is aware that a number of other jurisdictions are proactively supporting innovation, such as the recent announcement of the European Commission and European Investment Fund (“EIF”) which has launched a new investment program for the benefit of developments in Artificial Intelligence (“AI”) and blockchain technology. The EIF is initially scoped at €400 million (which includes an initial EIF investment of €100 million and an expectation of €300 million generated from other private investors ‘crowding in’) but could grow to €2 billion over time.<sup>1</sup>

*3.2 Staffing, recruitment and talent retention*

In Pepperstone’s experience, access to talent and retention of talent is a genuine issue in Australia. The local talent pool is small, and larger firms with more established global presences can offer salaries that are difficult for Australian businesses to match. On multiple occasions Pepperstone has completed an interview process with a candidate and offered them a position, only to have the candidate use that offer to leverage a better salary in another much larger company with a more well-known brand.

There are also some complexities around organising specialised work visas to bring talent from overseas into Australia. Pepperstone recently faced an issue with the Department of Immigration, which examined some roles in the company based on a traditional definition of the role titles, without comprehending that the online nature of the business and complexity of its product offering required a different and more specialised set of skills than the titles suggested. The end result of this misunderstanding was that Pepperstone was unable to reintegrate some staff operating in an overseas office into its Australian business.

*3.3 Collaboration and partnerships with other nascent firms and traditional financial services firms.*

It can be difficult for Pepperstone to collaborate with traditional financial services firms because many are reluctant to work with a new type of product or service or are restricted by their internal policies from bringing on a partner with such a niche and complex product offering.

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<sup>1</sup> See European Investment Fund, “Why do we need to support blockchain and AI in Europe?”, 20 November 2019: <https://medium.com/@eif4smes/why-do-we-need-to-support-blockchain-and-ai-in-europe-30a122383f33>

Many of the major banks in Australia may find innovative or exotic products too risky, limiting the ability for a Fintech like Pepperstone to engage with them as traditional payment partner. Unsurprisingly the banks have become even more conservative following the Royal Commission and the actions being taken by regulators such as ASIC in response to it.

Pepperstone has found that, even if a traditional financial services business is willing to enter into a partnership, we have been required to produce expensive legal advice or undertake independent audits prior to entering into a relationship in order to satisfy the counterparty about its standing from a risk perspective. Whilst Pepperstone is in the financial position where we are able to bear the costs of engaging in such processes, this is likely to be too costly for start-up firms.

Some of the traditional financial service firms like the banks are also choosing to create their own spin-off companies to take advantage of new FinTech opportunities. This means they are less likely to want to fully support firms that will be their competitors.

### *3.4 Opportunities to expand into overseas markets*

Australia has a good reputation as a strong, reliable, respectable jurisdiction, which is a real advantage when expanding to overseas markets.

Regulated businesses like Pepperstone have to undertake thorough research when expanding overseas as other jurisdictions will have their own requirements that may be not be consistent with Australian standards. When it comes to financial services, there will also be capital obligations and potentially the requirement to have a physical presence onshore which can greatly add to the cost of international expansion.

As mentioned in our previous submission, we do not necessarily believe it would be beneficial for the Australian Government to try to achieve equivalence with overseas jurisdictions in all innovative products, as that is likely to lead to over-regulation which would have the effect of limiting innovation.

However, it would be helpful for local FinTech businesses to have some source of truth which provides detailed guidance of the requirements and obligations in each jurisdiction so that they can make an educated plan as to where it would be beneficial to them to expand.

### *3.5 Issues affecting your business that may be specific to your product niche or area of specialisation (rather than affecting the FinTech and RegTech sectors as a whole)*

Please refer to our previous response for some of the issues that have been impacting our business in recent times.

## **4. What are your views on recent and forthcoming changes to policy settings and regulatory initiatives affecting the sector (e.g. implementation of the new Open Banking framework; introduction of the NPP in 2018; and ASIC's FinTech regulatory sandbox)?**

We believe all these initiatives are positive. Having said that, there are some aspects that could be improved and some risks that should be considered as they evolve.

The easy transfer of customer information can greatly assist a migration between businesses. However, it is important that entities are not overly reliant on that information, particularly if it extends to customer identification information or if it is used to assess other things such as whether a product is actually suitable for them and will meet their needs. At the end of the day, it is the entity that is providing the service that is responsible and accountable for identifying and knowing their client. Relying on a third company's systems and processes that the business does not control, even if it is a big third-party provider, is not a guarantee that thorough due diligence has occurred or that the

information is up to date. A review of the recent anti money laundering cases against the major Australian banks provides an indication of how even their systems are not infallible.

The Select Committee has asked how quickly the implementation of the consumer data rights (“**CDR**”) reforms should be broadened to related financial sectors such as superannuation. Pepperstone suggests that a review is undertaken regarding the success of the program in the banking sector once it has operated for at least a year prior to proceeding to implement it in other sectors. This will demonstrate the usefulness of the data and may indicate areas that can be improved. The review could also focus on any potential to streamline the requirements, reducing the cost that may be applicable to those firms required to implement it.

In terms of the ASIC's FinTech regulatory sandbox, Pepperstone understands that it has had very limited use to date (it appears around 7 FinTech firms have participated<sup>2</sup>) and it is unlikely to be able to be used by many FinTech firms because of the strict limitations associated with it. We also note several of the FinTech firms that did rely on the licensing exemption do not appear to have gone on to obtain an Australian Financial Service (“**AFS**”) licence after the exemption ended.

Even though the sandbox has not had many users, Pepperstone considers that AFS and credit licensing are very important protections for investors, so we would not suggest expanding the availability of the sandbox beyond what is currently contemplated. However, we note that obtaining an AFS or credit licence or varying a licence can be a complicated and time-consuming process. ASIC measures its success if it grants or varies at least 70% of applications licence by 150 days and 90% in 240 days.<sup>3</sup>

Longer timeframes are normally due to the complexity of the application. FinTech innovation is often complex because of its novel nature, so licence applications are therefore likely to take more time for FinTech firms.

We consider that providing additional resourcing to the license approval team or teams, particularly with FinTech understanding or expertise, would help to reduce those timeframes, it would also enable more support to be provided to applicants.

We also consider that specific guides, checklists and easy to find information relevant to the licensing requirements for FinTech products and services would also improve the licensing process and open opportunities for FinTech entities.

On this point, we are supportive of ASIC's statement in their 2018-19 Annual Report that it is allocating funding towards:

*“developing a Licensing Technology-Assisted Guidance (TAG) Tool (potentially a chatbot), designed to provide guidance on ASIC's licensing framework.”<sup>4</sup>*

## **In conclusion**

We remain fully supportive of the work being undertaken by the Select Committee. We strongly believe countries that encourage the development of both FinTech and RegTech industries will benefit both from the innovations themselves and the broader economic gains that these industries can bring with them.

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<sup>2</sup> <https://asic.gov.au/for-business/innovation-hub/fintech-regulatory-sandbox/regulatory-sandbox-licence-exemption-users/>

<sup>3</sup> See ASIC Service Charter performance, 2018–19: <https://asic.gov.au/about-asic/what-we-do/how-we-operate/performance-and-review/asic-service-charter/asic-service-charter-results-2018-19/>

<sup>4</sup> ASIC Annual Report 2018-29 page 136.

We hope this submission has provided some assistance. We are happy to provide additional information if required.

Yours Sincerely,

Tamas Szabo  
**Group CEO**  
**Pepperstone**