

Submission to the Select Committee on Financial Technology and Regulatory Technology

**“Building Australia’s FinTech Ecosystem:
Innovation Hubs for Competitive Advantage”**

by

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Australia is very well placed to benefit from the FinTech revolution.¹ We have over 600 FinTech enterprises² far more than Hong Kong,³ Singapore⁴ or Switzerland⁵ and nearly half

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¹ This submission is based on: R P Buckley, D W Arner, R Veidt and D A Zetsche, ‘Building Fintech Ecosystems: Regulatory Sandboxes, Innovation Hubs and Beyond,’ (5 November 2019) Law Working Paper Series 2019-010; available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3455872; and draws also from: D A Zetsche, R P Buckley, D W Arner and J N Barberis, ‘Regulating a Revolution: From Regulatory Sandboxes to Smart Regulation’ (2017) *23 Fordham Journal of Corporate and Financial Law* 31-103.

² I Pollari and D Teper, ‘Australian Fintech Landscape’, KPMG, Sep 11, 2018 <https://home.kpmg/au/en/home/insights/2017/08/australian-fintech-landscape.html>.

³ Invest HK, ‘Connected to Win’, Dec 17, 2018 <http://www.hongkong-fintech.hk/en/news/connected-to-win.html>.

⁴ Monetary Authority of Singapore, ‘FinTech Ecosystem’ https://www.mas.gov.sg/annual_reports/annual20172018/fintech-ecosystem.html.

⁵ Lucerne University, ‘Who Will Survive the FinTech Evolution’, Feb 27, 2019 <https://www.hslu.ch/en/lucerne-university-of-applied-sciences-and-arts/about-us/medien/medienmitteilungen/2019/02/27/fintech-studie-2019/>

as many as the UK.⁶ Our technological innovations in finance, particularly in regulatory solutions, are cutting-edge globally⁷ and strongly supported by the world-leading research done by Data 61. (By itself, Data61 is a real source of comparative advantage for us). The Consumer Data Right will be implemented in early 2020 for banking.⁸ CDR entitles consumers to see the data held about them, have it corrected if needed, and direct it as they see fit. For a range of reasons, CDR should prove more efficacious than comparable EU and UK regimes.

The CDR offers greatly increased competition in banking. FinTech offers major potential efficiency gains and substantial export opportunities -- there is great regional demand for FinTech solutions for unmet financial needs. The use of RegTech⁹ to facilitate compliance offers major savings to banks and lower consumer finance costs. The application of RegTech to bank supervision will greatly increase supervisory efficacy, allowing better understanding and containment of risk in real time.¹⁰

However, all of these benefits will only flow in full measure to Australia if our regulatory regime and approaches are effective in supporting continued development of Australia's FinTech and RegTech ecosystems.

Australia has led in the use of regulatory sandboxes and innovation hubs. Going forward, in order to support beneficial new innovation, we suggest that additional resources and focus on innovation hubs will produce the greatest benefits for further development of the vibrant and innovative FinTech ecosystem in Australia. We address three issues: (1) how to distinguish sandboxes from hubs; (2) how best to support development of a vibrant and innovative FinTech start-up ecosystem in Australia; and (3) how Innovation Hubs can be a source of competitive advantage for Australia.

1. Distinguishing sandboxes and hubs

⁶ UK, 'UK FinTech: State of the Nation', Apr 2019, 12
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/801277/UK-fintech-state-of-the-nation.pdf.

⁷ Treasury, 'Backing Australian FinTech: Australia's FinTech Advantages', Mar 2016
<https://treasury.gov.au/sites/default/files/2019-03/Fintech-March-2016-v3.pdf>.

⁸ *Treasury Laws Amendment (Consumer Data Right) Act 2019* (Cth).

⁹ RegTech for these purposes can be seen as a subset of FinTech and eligible for the same regulatory treatment.

¹⁰ L G Baxter, 'Adaptive Financial Regulation and Regtech: A Concept Article on Realistic Protection for Victims of Bank Failures', (2016) 66 *Duke Law Journal* 567, 604; D W Arner, J N Barberis and R P Buckley, 'FinTech, RegTech and the Reconceptualisation of Financial Regulation', (2017) 37 *Northwestern Journal of International Law and Business* 371, 375; D W Arner, J N Barberis and R P Buckley, 'The Emergence of RegTech 2.0: From Know Your Customer to Know Your Data', (2016) 44 *Journal of Financial Transformation* 79, 84.

Most financial systems around the world are insufficiently competitive. As a response many regulators seek to promote innovation, and new entrants, in their systems to promote competition (and efficiency among other policy goals).

In Australia, the Australian Securities and Investments Commission (ASIC) has two pro-innovation facilities -- its FinTech regulatory sandbox (Sandbox) and its Innovation Hub. Following the lead of the Financial Conduct Authority in the UK, ASIC was a very early adopter of these measures. More recently both types of facilities have become quite common and accepted, globally.

The ASIC Sandbox and Innovation Hub are two distinct approaches. Each is designed to support startups and scaleups navigate Australia's financial regulatory system.¹¹

Sandboxes

A sandbox is a safe environment which grants relief from certain regulatory requirements and in which approved participants can experiment and test innovative FinTech. Regulators typically use a sandbox to promote innovation and competition in the financial services sector, to announce that the economy is open for FinTech business and to learn about cutting edge technological developments. Sandboxes promote a 'test and learn' method to facilitate innovation and new technology.¹² The ASIC sandbox involves conditional licensing relief and a 'class waiver', which seeks to reduce business costs and the time to market, and enables the trialling and honing of FinTech for up to 12 months prior to full market launch.¹³

Sandbox participants have to be adequately prepared to enter the sandbox, their business needs to be more developed than those making enquiries at an innovation hub and they typically will need time to adjust to the regulatory test environment. This is resource intensive and not necessarily a streamlined process.

Innovation hubs

An innovation hub is a portal through which industry can readily access regulators to discuss proposed FinTech innovations and seek regulatory guidance and potential regulatory relaxations. Regulatory approaches within hubs globally differ in terms of the mode of interaction, whether advice is binding or non-binding, and the transparency of outcomes. The ASIC Innovation Hub is designed for FinTech businesses that need assistance with obtaining a financial services licence or a credit licence.¹⁴

¹¹ ASIC, 'Innovation Hub' <https://asic.gov.au/for-business/innovation-hub/>.

¹² ESMA, EBA and EIOPA, *Report FinTech: Regulatory Sandboxes and Innovation Hubs* (2018) JC 2018 74, pp. 5-6.

¹³ See generally, ASIC, 'Testing Fintech Products and Services Without Holding an AFS or Credit License', Aug 2017, Regulatory Guide 257.

¹⁴ R P Buckley, D W Arner, R Veidt and D A Zetzsche, op cit n 1, 18; ASIC, 'ASIC and Fintech' <https://asic.gov.au/for-business/innovation-hub/asic-and-fintech/is-my-fintech-company-eligible-for-assistance/>.

Because the short experience with these initiatives shows stand-alone sandboxes are not the most effective means of furthering FinTech innovation, a number of prominent financial centres have opted to exclusively use innovation hubs. For instance, most regulatory agencies in the United States, Germany and Luxembourg have expressly refrained from introducing sandboxes and instead rely on innovation hubs to promote their FinTech start-up ecosystems.

Innovation hubs typically provide specialist technical expertise and communicate tailored responses efficiently. This is because innovation hubs represent a new branding of the long-standing practice of regulators of responding to ad hoc enquiries, in particular concerning the regulatory perimeter. This new branding, however, matters as a hub facilitates easy access to the regulator – something that was missing in the old way of doing things, especially for new entrants to the industry without regulatory connections.

The ASIC Innovation Hub enables market participants who lack familiarity with regulatory issues to engage with ASIC easily. Sandboxes impose more constraints than hubs, meaning that they are effective in figuring out how new business models and technologies should be regulated but less effective at more broadly supporting the creation of new business models and technologies.

Common attributes

Innovation hubs and sandboxes share the common goals of fostering innovation and, through the two-way interaction with industry, increasing regulator knowledge of financial innovation.¹⁵

Our research on this issue in the past few years suggests strongly the broader financial innovation tends to be supported by innovation hubs, while regulatory sandboxes tend to attract the headlines and attention. Anecdotal evidence suggests most regulatory enquiries raised in connection with sandboxes can effectively be resolved without a live test environment; and innovation hubs can closely resemble sandboxes when given the power to modify unduly burdensome, or inappropriate, regulations by issuing waivers or ‘no action’ letters.

Distinguishing attributes

Sandboxes and innovation hubs can be distinguished by eligibility requirements. Eligibility requirements for sandboxes have to be, and are, stringent whereas innovation hubs are, in principle and subject to resource constraints, open to all relevant parties.¹⁶

A sandbox, in basic terms, is a safe space with a far reduced regulatory burden for those privileged to enter. For this reason, the entry portal cannot be wide, or it will put consumers at risk. A hub, on the other hand, merely facilitates a dialogue with the regulator, so doesn’t

¹⁵ ESMA, EBA and EIOPA, op cit n 12, pp. 18-19.

¹⁶ R P Buckley, D W Arner, R Veidt and D A Zetsche, op cit n 1, 6 and 1010; and CCAF, ‘Guide To Promote Financial & Regulatory Innovation: Insights From the UK’, Mar 2018, 19.

need tight eligibility requirements at all. It is thus a more open process and one which tends to have a broader impact.

2. Promoting a vibrant, innovative FinTech start-up ecosystem in Australia

Usage of Sandboxes

Despite the media attention given to sandboxes, the number of businesses using sandboxes worldwide is small. In Australia, six entities have used the sandbox. In the United Kingdom, with a longer history and a much larger market, there have still only been a total of 89 sandbox users of the FCA sandbox to date.¹⁷ Although the FCA Sandbox take-up rate appears relatively high when compared to the ASIC Sandbox, the UK number is very small indeed relative to the total number of financial services businesses in the United Kingdom. A more comparable jurisdiction is Singapore where the Monetary Authority of Singapore (MAS) has supervised five entities in its sandbox (strictly so called).¹⁸ The number of businesses in the ASIC and MAS sandboxes are both very limited because, if access was broadened significantly, consumer protection would suffer. This reflects the purpose of sandboxes: a testing environment for models and technologies which have already been to a large extent developed. As a result their usage is limited by the number of business models and technologies reaching a sufficient stage of development and for which appropriate regulatory treatment is not already available. They are thus an important element in building an innovation ecosystem but not the one which has the widest potential impact.

Legislation to broaden access to Australia's sandbox has long been before parliament, but because the operative provisions will appear in subsidiary regulations, we don't yet know what the broadening of access will entail, and make no specific comment on it.

However, based on our analysis of global trends, it is likely, even in a reconfigured form, that any sandbox here will face considerable limitations in its impact as a result of the very nature of a sandbox.

We suggest that going forward, in addition to the sandbox, evidence here and abroad strongly suggests that even great benefit – and even real competitive advantage – can be secured through far better resourced innovation hubs.

¹⁷ FCA, 'Regulatory Sandbox' <https://www.fca.org.uk/firms/innovation/regulatory-sandbox>. The 89 sandbox participants are calculated from totalling the accepted firms to Cohorts 1, 2, 3 and 4.

¹⁸ MAS, 'Sandbox' <https://www.mas.gov.sg/development/fintech/sandbox>; and MAS, 'Sandbox Express' <https://www.mas.gov.sg/development/fintech/sandbox-express>. Three sandbox experiments in the Sandbox and two sandbox experiments in Sandbox Express.

Innovation hubs attract far more users than sandboxes. For instance, about 600 businesses have used the UK FCA Innovation Hub.¹⁹ Between March 2015 to December 2018, the ASIC Innovation Hub dealt with 380 businesses, provided advice to 347 businesses and granted new credit licenses to 69 businesses.²⁰ These user statistics are consistent with a 2019 survey conducted by the World Bank and CGAP which found that innovation hubs have a greater impact than sandboxes in terms of the number of FinTech business users.²¹ This is reflective of the different roles and purposes of the sandboxes and innovation hubs – and highlights the value of further focus on innovation hubs in Australia going forward.

Regulatory resources

The number of participants, of course, has major resource repercussions for regulators, and, in our view, sandboxes are popular with regulators globally because they are perceived as promising to facilitate innovation while also being ‘resource light’.²²

When a severely resource-constrained regulator (which is virtually all, globally) looks at a sandbox which offers a set of rules that should be largely self-administering, and compares it to a hub, which will require the allocation of full-time, highly skilled and experienced staff, the sandbox seems alluring. An innovation hub, in comparison, looks like a further drain on already stretched resources. This accounts, in our view, for the proliferation of sandboxes over hubs in many countries (though not among some of the most sophisticated regulators).

Staffing

If a regulator does not properly staff an innovation facilitator, this will minimize its impact on innovation and FinTech market development.

The ASIC hub provides access to senior staff which incurs a material human resource cost. By focusing on informal guidance, senior hub staff are used efficiently and participate in a highly interactive two-way knowledge exchange. This is vital for keeping ASIC at the cutting edge of technological developments.²³

Going Forward

¹⁹ FCA, ‘The Impact and Effectiveness of Innovate’, Apr 2019, 5
<https://www.fca.org.uk/publications/research/impact-and-effectiveness-innovate>. The figure is derived from the 686 supported firms minus 89 sandbox participants. The 89 sandbox participants are calculated from the accepted firms to Cohorts 1 to 4: FCA, op cit n 17.

²⁰ R P Buckley, D W Arner, R Veidt and D A Zetsche, op cit n 1, 18.

²¹ S Appaya and I Jenik, ‘Running a Sandbox May Cost Over \$1M, Survey Shows’, CGAP Blog, Aug 1, 2019 <https://www.cgap.org/blog/running-sandbox-may-cost-over-1m-survey-shows>.

²² R P Buckley, D W Arner, R Veidt and D A Zetsche, op cit n 1, 26.

²³ UNSGSA FinTech Working Group and CCFA, *Early Lessons on Regulatory Innovations to Enable Inclusive FinTech: Innovation Offices, Regulatory Sandboxes, and RegTech* (New York and Cambridge 2019), 25.

Going forward, we argue that the best way to support the development and competitiveness of Australia's FinTech and RegTech ecosystem is to focus greater attention and resources on innovation hubs.

Sandboxes can serve an important purpose as controlled testing and learning environments for businesses and regulators in the FinTech and RegTech developmental process. The efforts to broaden the appeal and use of our sandbox are timely. Australia needs a sandbox as having one sends a vital message to the market.²⁴ The sandbox term is well known worldwide and sends a message, more effectively than does the term 'innovation hub', that a regulator is pro-innovation, flexible, and open to engage with industry. This is a message very well worth sending.

While substantively we argue that a hub actually delivers these outcomes far better, different jurisdictions name their hubs in a wide range of terms, so no one term cuts through. However, the term, 'regulatory sandbox', does cut through. Perhaps we all crave a simpler, much earlier time in our lives. Who knows? But the evidence is clear, industry seems attracted to jurisdictions which have something labelled a 'sandbox'.

In terms of resources going forward we need to focus efforts and resources on building innovation hubs, as this will have the greatest impact on further developing a vibrant and innovative FinTech start-up ecosystem in Australia.

3. How innovation hubs can be a source of competitive advantage for Australia

Although sandboxes and innovation hubs are now popular worldwide there has been very little analysis of how countries might leverage a competitive advantage from such initiatives. For Australia, such an advantage would come from the ASIC hub and sandbox supporting the development of a highly innovative FinTech start-up ecosystem in the Asia-Pacific region. Australia's principal regional competitor is Singapore, which has the most developed FinTech start-up ecosystem in the region.

Singapore refers to its suite of pro-innovation measures as a sandbox. However, in Singapore this effectively incorporates all of the services of a hub, and delivers the functions of both a sandbox and a hub. Of late, MAS has attempted to streamline its application process by introducing a second sandbox, Sandbox Express, which fast-tracks approvals for activities where risks are low and well understood by the market. Eligibility to MAS' Sandbox Express is, however, restricted to three types of FinTech businesses. Sandboxes are not a one-size-fits-all solution and there are other innovation facilitator approaches which are more efficient, nimble, responsive to the market and appropriate to specific circumstances.²⁵ Sandbox Express may be more efficient and responsive than conventional sandboxes in terms of approvals, but it remains inflexible and unable to adjust to specific

²⁴ R P Buckley, D W Arner, R Veidt and D A Zetzsche, op cit n 1, 6-7; and D A Zetzsche, R P Buckley, D W Arner and J N Barberis, op cit n 1, 92.

²⁵ I Jenik, 'Regulatory Sandboxes and Financial Inclusion', CGAP, Oct 2017
<https://www.cgap.org/research/publication/regulatory-sandboxes-and-financial-inclusion>.

circumstances outside MAS' three designated FinTech business models. Any benefits stemming from Sandbox Express have so far been negligible because it has only approved two users to test for nine months each. Usage of Sandbox Express is consistent with our research on low sandbox user levels.

A sandbox's ability to promote innovation is limited unless it is incorporated into a wider innovation facilitator ecosystem. In our view, Australia can gain a substantial competitive advantage over Singapore by focusing on, and expanding the resourcing of, innovation hubs, following the model of the ASIC Innovation Hub. This could well include revisiting, and considering widening, its regulatory powers to grant 'no-action letters', tailored dispensations and waivers. Widening the powers of the ASIC hub is not a step into the unknown, as similar approaches have been undertaken by financial regulators around the world for many decades.

In our view, innovation hubs are highly effective in providing startups and scaleups with access to regulators and regulatory advice and tend, on balance, to do much to promote innovation and competition in a financial system.