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Australia Needs a Better Model for Its Enhanced Fintech Sandbox*

Submission to the Select Committee on Australia as a Technology and Financial Centre

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This submission proposes a reform of Australia's FinTech sandbox, which has been recently modernised but still suffers from old design flaws.

More specifically, it is submitted that:

- the Enhanced Regulatory Sandbox is inconsistent with the chosen notice-based model;
- alignment of ASIC's and APRA's regulatory sandboxes is desirable;
- the non-interactive design of the Enhanced Regulatory Sandbox can be described as a 'solution waiting for a problem' and is therefore inefficient; and
- the issues identified in this submission can be resolved by switching to an authorisation sandbox model of the kind that is widely used globally and that is more easily understood by FinTechs.

This brief submission only outlines the key arguments. If more detail is needed, a comprehensive analysis of this matter is available in my forthcoming publication in the *University of New South Wales Law Journal* (which can be downloaded here).

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* This submission is based on the author's publication: Anton N Didenko, 'A better model for Australia's enhanced FinTech sandbox' (2021) 44(3) *University of New South Wales Law Journal* (forthcoming) <https://ssrn.com/abstract=3866585>. This research was funded by the Australian Government through the Australian Research Council (project FL200100007 'The Financial Data Revolution: Seizing the Benefits, Controlling the Risks'). The views expressed herein are those of the author and are not necessarily those of the Australian Government or Australian Research Council. Thanks to Ross Buckley for his input and guidance.

1. Background

Australia has already made substantial progress in attracting technological innovation in finance. Between 2014 and 2020, the number of FinTech start-ups increased more than seven-fold, from less than 100[1] to over 700 firms.[2] This puts Australia into the same league as Hong Kong (with over 600 FinTech start-ups)[3] but still behind Singapore (with over 1,000 FinTech firms)[4] and the UK, which hosts over 1600 FinTech companies.[5] It is clear that Australia's sandbox framework was developed amidst fierce international competition that shows no signs of slowing down. Although the FinTech landscape in Australia is becoming increasingly diverse, the regional and global competitors are launching new regulatory initiatives and programmes to support FinTech that may sway innovators. And so continues the global race to attract FinTech talent.

As part of this race, in 2020 Australia replaced ASIC's '*fintech licensing exemption*' ('**FLE**'), which had attracted only seven firms[6] over almost four years of operation, with the so-called '*enhanced regulatory sandbox*' ('**ERS**').

2. What exactly has been 'enhanced'?

The ERS did not change the sandbox model and follows the same *non-authorisation* approach as the FLE: technically there is no formal application process and firms intending to make use of the sandbox need to submit an advance *notice* to ASIC before commencing the testing phase. In line with its predecessor, the ERS retains minimal interactivity between ASIC and eligible firms (with no mandatory reporting in either case).

It is fair to say that the word 'enhanced' in the ERS is a synonym of 'expanded'. Among other things, the ERS offers a much longer testing period (two times longer compared to the FLE)[7] and admits new types of activities into the sandbox (such as crowd-funding services and provision of credit). At the same time, FinTech firms are required to give a much earlier

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1 KPMG, 'Scaling the Fintech Opportunity: For Sydney & Australia' (Issues Paper 17, July 2017) 7 <https://assets.kpmg/content/dam/kpmg/au/pdf/2017/scaling-fintech-opportunity-sydney-australia.pdf>.

2 Ian Pollari and Daniel Teper, 'Australian Fintech Landscape 2020', *KPMG* (Web Page, 21 December 2020) <https://home.kpmg/au/en/home/insights/2017/08/australian-fintech-landscape.html>.

3 'Fact Sheet: Hong Kong Fintech Landscape', *InvestHK FintechHK* (Web Page, 16 March 2021) <https://www.hongkong-fintech.hk/en/insights/news/news-2021/fact-sheet-hong-kong-fintech-landscape/>.

4 'FinTech and Innovation', *Monetary Authority of Singapore* (Web Page, 10 May 2021) <https://www.mas.gov.sg/development/fintech>.

5 UK Department for International Trade, *UK FinTech: State of the Nation* (Report, 2019) 12 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/801277/UK-fintech-state-of-the-nation.pdf>.

6 See ASIC, Submission No 14 to Senate Select Committee on Financial Technology and Regulatory Technology, Parliament of Australia (December 2019) 9 [27].

7 Not considering sandboxes without a pre-defined maximum duration of a sandbox test, only a handful of regulatory sandboxes (such as the FinTech Regulatory Laboratory of the Abu Dhabi Global Market) offer such a long testing period: see, eg, Abu Dhabi Global Market, 'The Fintech Regulatory Laboratory: The Regime for FinTech Innovation' (Brochure, February 2020) <https://www.adgm.com/documents/publications/en/fintech-regulatory-authority-brochure.pdf>.

advance notice before the start of the test (at least 30 days in advance,[8] compared to just 14 days under the FLE[9]).

3. Why the new sandbox framework remains unsatisfactory

While the ERS offers a much wider range of testing opportunities in the financial sector, the 2020 sandbox revisions have failed to address the fundamental issues that undermined the effectiveness of the FLE. These are discussed below.

3.1. Enhanced sandbox is inconsistent with the chosen notice-based model

The ERS incorporates a number of features typical for an authorisation-based[10] sandbox model that create major obstacles to the proper functioning of Australia's seemingly unique notice-based sandbox design.

3.1.1. Missing gatekeeper

Screening of prospective participants is the key feature of any authorisation sandbox that allows regulators to exercise the gatekeeping function by admitting only those businesses that truly innovate and minimise end-user risks. In Australia, the screening of sandbox candidates has taken an unusual shape but has not disappeared completely. Instead of applications, FinTech firms must send *notices* to ASIC before testing starts (14 days in advance under the FLE and 30 days in advance under the ERS). There are three issues with this approach.

First, neither the FLE, nor the ERS *requires* ASIC to perform the screening: FinTech firms may start their test immediately upon the expiration of the notification period. Although technically ASIC may decide that the relevant firm should not be allowed to perform the test, nothing precludes ASIC from disregarding this power and instead interfering at a much later stage. This creates a conundrum. If screening of sandbox candidates is supposed to be voluntary, cursory or random, then the FLE and the ERS effectively have no gatekeeper in place. If, on the contrary, ASIC intends to review each notice before the start of the relevant test anyway (as the current language of *ASIC Information Sheet 248* seems to suggest), then the notice-based ERS sandbox already *de facto* follows the authorisation model (without acknowledging it).

Interestingly, the early design of the ASIC sandbox envisaged in the June 2016 public consultation[11] addressed the same issue quite differently. While the sandbox was not intended to follow an authorisation model and thus did not involve formal applications addressed to the regulator, the gatekeeping function was to be partially performed by third parties, known as 'sandbox sponsors':

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8 *Corporations (FinTech Sandbox Australian Financial Services Licence Exemption) Regulations 2020* (Cth) s 6(1)(c); *National Consumer Credit Protection (FinTech Sandbox Australian Credit Licence Exemption) Regulations 2020* (Cth) s 6(c).

9 *ASIC Corporations (Concept Validation Licensing Exemption) Instrument 2016/1175* (Cth) s 6(2); *ASIC Credit (Concept Validation Licensing Exemption) Instrument 2016/1176* (Cth) s 6(2).

10 Most FinTech sandboxes around the world follow the same authorisation-based model, which involves an application-based process of vetting individual requests for admission into the sandbox.

11 See *ASIC Consultation Paper* 260.

> We propose that the AFS licensing exemption … will apply only if the testing business is 'sponsored' by an organisation ('sandbox sponsor') recognised by ASIC.
>
> We propose that sandbox sponsors will be not-for-profit industry associations or other Government-recognised entities. The ASIC-approved sponsors would be named in the licensing exemption (and could be updated from time to time).[12]

According to ASIC, sandbox sponsors were expected to (i) reduce the underlying risks by 'declining to sponsor potential testing businesses that are more likely to engage in poor conduct' and (ii) 'remove the need for case-by-case approval from ASIC'.[13] In other words, sponsorship arrangements were supposed to provide comfort to ASIC, which did not intend to operate an authorisation sandbox and review each application:

> We agree that sandbox sponsors could play an important *gatekeeper role* as they would be sensitive to reputational risk associated with poor outcomes in the testing environment.[14]

After the public consultation, ASIC abandoned the idea of sandbox sponsorship, citing a range of reasons (such as the potential to confuse consumers, additional costs and competition concerns)[15] and with it, the very reason for not requiring 'case-by-case approval'. Although ASIC retained the overall supervisory function, with the removal of the sponsorship requirement, the gatekeeping function was not passed on to anyone (ASIC did not inherit this duty, since it was under *no obligation* to vet prospective participants). The 2020 ERS regulations also failed to address this gap. In *ASIC Information Sheet 248*, ASIC seems to suggest that it is prepared to be actively involved in analysing notices from ERS users – but this readiness does not affect the design of the ERS, which requires no approval before testing can commence. In this sense, *ASIC Information Sheet 248* needs better drafting and alignment with the ERS regulations.[16]

Second, the role of notices to ASIC remains unclear. On the one hand, ASIC assumes no duty to review them. On the other hand, the licensing waiver under the ERS is only available once the (30-day) notification period has ended 'without ASIC giving … written notice of a decision … relating to the notification'.[17] In *ASIC Information Sheet 248*, ASIC rather confusingly states that ERS participants can start their test if ASIC confirms 'that [the] notification satisfies the minimum requirements'.[18] What should one make of this caveat? If ASIC indeed reviews each notification – as *ASIC Information Sheet 248* and its submission to the Select Committee on

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12 Ibid 32 [92].

13 Ibid 33 [94].

14 Ibid 33 [95] (emphasis added).

15 *ASIC Response to CP 260 Submissions (Report 508)* 17–18.

16 For example, it includes a section entitled 'How to *apply* for the ERS exemption' (emphasis added), which clearly goes against the notice-based non-authorisation design envisaged by the ERS regulations: see *ASIC Information Sheet 248*.

17 *Corporations (FinTech Sandbox Australian Financial Services Licence Exemption) Regulations 2020* (Cth) reg 6(1)(c); *National Consumer Credit Protection (FinTech Sandbox Australian Credit Licence Exemption) Regulations 2020* (Cth) reg 6(c).

18 *ASIC Information Sheet 248*.

Financial Technology and Regulatory Technology seem to suggest – then the 'non-authorisation' approach effectively becomes a fiction.[19]

Third, if ASIC indeed keeps reviewing all the sandbox notifications submitted to it but maintains the current non-authorisation model, then the procedure established by the ERS makes all firms in the sandbox *collectively worse off*. It is logical to assume that review of sandbox notifications does not occur strictly on the 30th day following submission, especially in case of multiple concurrent submissions. If this assumption is correct, it is likely that at least some notifications will be reviewed before the deadline (and, depending on the regulator's workload, some may be reviewed very quickly). However, under the ERS, even if a decision is made that a FinTech firm is eligible for the sandbox, such firm cannot start testing until the expiration of the entire (30-day) notification period. Since the latter has more than doubled compared to the FLE (from 14 to 30 days), it follows that eligible FinTech firms are collectively in a worse position compared to an authorisation sandbox (where eligible entities can receive the green light as soon as their application has been reviewed and approved) and compared to the FLE (where the notification period was just 14 days).

3.1.2. Grounds for early termination

Grounds for early termination of sandbox privileges are another puzzling area of the ERS. While there is little doubt that regulators are likely to retain at least some powers to stop a firm's participation in a sandbox test even in a non-authorisation sandbox, in Australia the scope of this residual authority is hard to justify. Previously, under the FLE, ASIC was empowered to terminate a firm's access to the sandbox if the relevant activities '[were] not innovative and/or [did] not use technology'[20] – thus putting Australian FinTech firms in a position of uncertainty that does not arise for an authorisation sandbox model (where assessment of innovativeness is part of the admission test).

The ERS expands the grounds for terminating sandbox privileges and, just like in the FLE, grants ASIC the authority to stop the test if the relevant service or activity is not innovative. Somewhat usefully, *ASIC Information Sheet 248* states that a notice to ASIC must explain that the relevant firm meets the newly established 'innovation test'.[21] This new test, which would look natural and logical in any authorisation-based sandbox, seems oddly out of place in the ERS, which remains *notice*-based. The ERS remains non-interactive and does not involve any dialogue with ASIC that could help quickly resolve certain issues – for example if ASIC's decision to prohibit the sandbox test is based on a technicality. Even though ASIC's review of any resubmitted notice is likely to be a lot quicker, any resubmission would invariably trigger, again, a full 30-day notice period under the current design before any testing can commence.

Under the ERS regulations, if for some reason ASIC fails to review any sandbox notice received within 30 days, the testing period will commence automatically (but remain under the

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19 In its December 2019 submission, ASIC provided the following assessment of sandbox notifications: 'A total of seven entities have participated in the ASIC Sandbox. A further 44 entities have submitted preliminary notifications but do not meet the criteria necessary to qualify.' This suggests that the regulator is reviewing all notifications: see ASIC, Submission No 14 to Senate Select Committee on Financial Technology and Regulatory Technology, Parliament of Australia (December 2019) 9 [27].

20 *ASIC Regulatory Guide 257* RG 257.55.

21 ERS users are expected to explain 'why each eligible financial service, financial product or credit activity is considered either new or a new adaptation or improvement of another service': see *ASIC Information Sheet 248*.

risk of a subsequent determination that the activity is not sufficiently innovative). However, since FinTech firms operating in the sandbox are not required to provide any interim reports concerning the status of their testing progress, no fresh data would be flowing to ASIC from the relevant test – and thus a subsequent decision to terminate access to the sandbox while the test is already underway is likely to be based on the old information included in the notification – rather than on some new development that could not have been predicted.

3.1.3. Economy of Resources

In the context of the existing notice-based sandbox model, it is important to consider one of the perceived benefits it brings – the economy of regulator's resources (which, ideally, should stem from the absence of an applicant screening procedure and ongoing monitoring, rather than from the lack of participants). After all, multiple regulators have suggested that sandboxes are not cheap,[22] and thus it is important to consider the costs of operating a FinTech sandbox.

However, it would be too simplistic to just analyse whether the ERS is cheaper compared to its international authorisation-based counterparts. All else being equal, a regulatory initiative that does not require the regulator to review each sandbox application and each interim report provided by sandbox participants has to be less expensive than the one that does. However, a better approach is to consider whether the expected (and guaranteed) cost savings from the enhanced sandbox are properly aligned with the chosen (notice-based) sandbox model. This approach is not limited to the analysis of a regulator's available resources, but considers, among other things, whether in pursuit of cost savings regulators may inadvertently trigger other negative consequences, such as misaligned consumer expectations.

Back in 2017, in response to the ERS public consultation, ASIC made it very clear that direct supervision of unlicensed sandbox entities within the sandbox was neither desirable, nor realistic:

> These will be unlicensed entities and as such ASIC will not monitor or supervise them. This is consistent with our approach to the ASIC regulatory sandbox. While ASIC does monitor and supervise existing licensed businesses this is supported by a broad regulatory toolkit and framework applicable to licensed financial services. We *do not have this capacity or capability* for unlicensed entities.[23]

In contrast, the wide scope of the final ERS regulations and ASIC's own *Information Sheet 248* suggest that the regulator is expected to play a *more active* role in the entire process, by utilising its broad new powers to terminate access to the sandbox on new grounds, such as ASIC's conclusion that the benefits of the sandbox are unlikely to outweigh the detriment to the

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22 United Nations Secretary-General's Special Advocate for Inclusive Finance for Development FinTech Working Group and Cambridge Centre for Alternative Finance, 'Early Lessons on Regulatory Innovations to Enable Inclusive FinTech: Innovation Offices, Regulatory Sandboxes, and RegTech' (Report, 2019) 31 <https://www.unsgsa.org/files/2915/5016/4448/Early_Lessons_on_Regulatory_Innovations_to_Enable_Inclusive_FinTech.pdf>.

23 ASIC, Submission to The Treasury, *Enhanced Regulatory Sandbox Proposal* (10 November 2017) 3 (emphasis added).

public,[24] or that the relevant activity is likely to cause significant detriment to customers.[25] Effectiveness of these new powers under the ERS will depend on two key factors: (i) availability of up-to-date data about the sandbox test and (ii) ASIC's ability and willingness to use those powers. The first factor is likely to be problematic, given the absence of ongoing reporting obligations under the ERS (as mentioned previously). The second is unlikely to be realistic either, considering ASIC's submission in 2017, in which the regulator admitted:

> Given the policy approach that the entities in the sandbox be unlicensed and the approach to supervision set out above we envisage this power will not be commonly used.[26]

Eventually, ASIC concluded that 'it may be worth considering removal of the power' altogether, due to (i) the large potential number of firms relying on the licensing exemption and (ii) the fact that 'it might confuse consumers by suggesting that ASIC supervises these businesses'.[27] While it is too early to discuss the first ground (ie the number of FinTech entities interested in the ERS), one should consider the specific implications of the second one (ie misaligned consumer expectations).

Coexistence of the new monitoring powers under the ERS, on the one hand, and the absence of 'capacity or capability' (in ASIC's own words) to monitor unlicensed entities, on the other, puts the regulator in an unenviable position. Indeed, how would ASIC characterise its own standard of engagement with firms relying on the ERS? It would no doubt be inconvenient to admit that the regulator has insufficient resources to control the risks and protect the consumers, or, worse yet, voluntarily chooses not to monitor unlicensed businesses when it is authorised to do so in the first place. Thus, if ASIC does not plan to exercise its monitoring powers and is unlikely to possess the data required for such monitoring anyway, what reason does the expansion of those powers in the ERS serve? In this setting, the use of limited resources to vet prospective applicants (as is common for authorisation sandboxes) is likely to be not only more efficient, but also better aligned with consumer expectations.

In other words, this submission does not posit that the current non-authorisation sandbox model brings no cost savings – it most likely does. Instead, it argues that these potential savings do not justify the supervisory model implemented as part of the ERS.

3.1.4. Undue Complexity

The last, but arguably the most important, perceived inconsistency stems from the increased complexity of the ERS, compared to the FLE. Even disregarding the previous discussion, a critical aspect of any regulatory sandbox is its usability. In authorisation-based sandboxes, much of the anxiety is relieved due to the formal application process and resulting information exchange with the regulator.

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24 *Corporations (FinTech Sandbox Australian Financial Services Licence Exemption) Regulations 2020* (Cth) reg 8(b); *National Consumer Credit Protection (FinTech Sandbox Australian Credit Licence Exemption) Regulations 2020* (Cth) reg 8(1)(b).

25 *Corporations (FinTech Sandbox Australian Financial Services Licence Exemption) Regulations 2020* (Cth) reg 8(i); *National Consumer Credit Protection (FinTech Sandbox Australian Credit Licence Exemption) Regulations 2020* (Cth) reg 8(1)(h).

26 ASIC, Submission to The Treasury, *Enhanced Regulatory Sandbox Proposal* (10 November 2017) 3.

27 Ibid.

The ERS is different. In the words of Mark Adams (ASIC's Senior Executive Leader leading the Innovation Hub), under the ERS ASIC aims to apply a so-called 'pragmatic approach': in making assessments, the regulator will only rely on the information provided in any ERS notice and information sourced by ASIC itself.[28] ASIC is not planning to seek additional information or do any additional work in making its assessment because 'time does not permit that'.[29] Regulators are known to have limited resources. So be it.

But let us now consider the other, non-regulatory, perspective. If the only meaningful feedback from the regulator within the ERS takes the shape of a response confirming or denying compliance with eligibility parameters, the onus is on FinTech firms to 'get it right' on the first attempt, to avoid wasting time on resubmissions and resetting the 30-day timer. In this setting, the ease of use and clarity of eligibility requirements become critical to attract innovators. Unclear, complex requirements make FinTech firms spend additional time and expense (eg on legal consultants), which undermines the usefulness of the ERS as an accessible sandbox format to promote innovation.

Unfortunately, instead of simplifying the access requirements, the ERS has only *grown in complexity*, compared to the FLE. In particular, the ERS implements two new tests: the net public benefit test and the innovation test defined in *ASIC Information Sheet 248*. ERS users are essentially required to make a self-assessment against vague and non-specific criteria that are based on the new requirements, all while considering the underlying terminology that is far from straightforward.[30] Ironically, the adequacy of the innovation requirement has already been questioned in the academic literature: Buckley et al argue (in the context of the FLE) that the task of assessing the degree of novelty is 'arguably beyond [the regulators'] skill set, and one that ASIC … expressly chose not to undertake'.[31] And yet, after finally replacing the FLE, the ERS has formally introduced the innovation test.

Somehow, the desire to enhance the original regulatory sandbox has produced an outcome that combines the key features of authorisation sandboxes (such as the *ex ante* test of innovativeness) without offering FinTechs the matching application-based regime and the opportunities for a formal dialogue with the regulator within the sandbox framework (informal assistance can still be provided by the Innovation Hub but it is hardly sufficient – for if informal support alone was sufficient, there would be no need for a regulatory sandbox in the first place).

3.2. The desirability of aligning ASIC's and APRA's sandboxes

While APRA's restricted ADI ('RADI') regime has not been associated with the sandbox terminology, it also qualifies as a regulatory sandbox. First, the RADI regime facilitates

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28 ASICmedia, 'The Government's Enhanced Regulatory Sandbox: ASIC Overview Webinar' (YouTube, 1 September 2020) 00:20:33 <https://www.youtube.com/watch?v=OUP9lheOv0c>.

29 Ibid 00:21:16.

30 For example, *ASIC Information Sheet 248* uses the term 'significant decision makers', which the draft notification form defines as 'any person(s) … (i) who is not an employee or director of the applicant or of any related body corporate of the applicant; and (ii) whose role includes being responsible for making significant decisions about the ongoing provision of each eligible credit activity': see, eg, 'Notification to Use the Enhanced Regulatory Sandbox Exemption to Test Eligible Credit Activities', *ASIC* (Form, 1 September 2020) 6 [6] <https://download.asic.gov.au/media/5772214/20200826_notification-to-use-the-enhanced-regulatory-sandbox-exemption-credit.pdf>.

31 Ross Buckley et al, 'Building Fintech Ecosystems: Regulatory Sandboxes, Innovation Hubs and Beyond' (2020) 61 *Washington University Journal of Law & Policy* 62–3.

innovation in finance, in particular by online-only banks. Second, a RADI licence allows engagement of real customers (subject to various disclosure obligations), including not only staff of the RADI itself and family and friends of staff, but also the general public, depending on the type of products offered.[32] Third, the RADI licensing regime is closely supervised by APRA, which recovers the costs of supervision via the annual supervisory levy.[33] The level of regulatory involvement is high, especially when compared to the FLE, and involves pre-application consultations, review of applications and, for successful applicants, on-going engagement with the RADI and formal progress reviews at least every six months.[34] Finally, a whole range of requirements, in particular, Prudential Standards, either do not apply, or are modified specifically for RADIs.[35]

Although APRA and ASIC have so far operated their respective sandboxes quite differently, each following a different model,[36] the revisions made as part of the ERS have brought the two regimes closer to each other. This raises the question: could these two sandboxes be better aligned and what benefits would this bring?

Under the FLE, overlaps between the two (APRA's and ASIC's) sandboxes were unlikely, not just due to the different time limits (12 months under the FLE and 24 months with possible extension under the RADI framework), but mainly as a result of the very narrow scope of activities permitted under the FLE. In contrast, the ERS matches the maximum duration of the RADI licence, allows extensions and expands the scope of ASIC's sandbox to include, among other things, credit activities.[37]

As part of international competition to attract FinTech talent, where two or more sandboxes operated by different regulators overlap, some overseas jurisdictions have offered joint administration of such sandboxes to facilitate sector-wide or even cross-sectoral testing. For example, Hong Kong's three financial services regulators (the HKMA, the Insurance Authority and the Securities and Futures Commission) are now offering a single point of entry for cross-sector FinTech solutions.[38]

A similar approach is likely to be useful to further promote APRA's and ASIC's pro-innovation philosophy. In addition, it would be perfectly aligned with the updated Memorandum of Understanding ('MoU') between these two regulators issued on 28 November 2019[39] as a

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32 APRA, *ADI Licensing: Restricted ADI Framework* (Information Paper, 4 May 2018) 24–5.

33 Ibid 15.

34 Ibid 28.

35 Ibid 31–6.

36 APRA's regime allows FinTech firms to obtain a restricted licence – not a licensing waiver – and thus follows the authorisation model.

37 See the definition of 'eligible credit activity' in *National Consumer Credit Protection (FinTech Sandbox Australian Credit Licence Exemption) Regulations 2020* (Cth) reg 5.

38 See, 'Fintech Supervisory Sandbox (FSS)', *Hong Kong Monetary Authority* (Web Page) <https://www.hkma.gov.hk/eng/key-functions/international-financial-centre/fintech/fintech-supervisory-sandbox-fss/>.

39 *Memorandum of Understanding between the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission*, signed 28 November 2019 <https://download.asic.gov.au/media/5362689/apra-asic-memorandum-of-understanding-2019.pdf> ('*APRA – ASIC Memorandum of Understanding*').

response to recommendations 6.9 and 6.10 of the *Hayne Royal Commission*.[40] Under the revised MoU, APRA and ASIC commit to engage with each other, 'having regard to each other's mandate and broader regulatory objectives'.[41] However, since the ERS offers minimal interaction between ASIC and eligible FinTech firms, in the sandbox context ASIC's ability to reach some of the key MoU objectives (such as agreement to 'proactively provide appropriate information' or to promptly respond to information and document requests)[42] is likely to be much lower compared to APRA, which actively engages with the RADI licence holders at all stages of the sandbox test.

3.3. Sandbox as a solution waiting for a problem?

Australia's unusual notice-based model of a FinTech sandbox demands precision, rewards foresight and punishes miscalculations much more than the typical (authorisation-based) sandbox design.

This is because the ERS is not an interactive form of a regulatory sandbox. By design, there is no ongoing information exchange with the regulator, no mandated periodic (or even final) reporting,[43] no possibility to apply for extension of the sandbox term (as there is no application process to begin with), and no better solution for FinTechs that quickly outgrow the limitations of the ERS than immediate exit from the sandbox.

The efficiency of a non-interactive notice-based sandbox model ultimately hinges on the *ability of the regulator to predict* the future direction of FinTech development in the relevant jurisdiction. Since there is no application process or dialogue with the regulator and no flexibility in modifying the sandbox parameters, such a sandbox model can be called a 'solution waiting for a problem'. If the relevant prediction is right, the sandbox works. If the calculation is incorrect, there is no demand and the sandbox becomes useless. This means that, for the ERS to be useful, it is not enough to admit that the 'low number of applications in the Australian context suggests that we're not doing it right' and consequently 'there is a need for reform'.[44] Comprehensive research is necessary. But since the earlier calculations relating to the FLE have not materialised,[45] the same could be true for the ERS and ASIC's prediction that the numbers of ERS users 'could be in the hundreds per year'.[46]

Another problem with any non-authorisation approach applied by regulators is that the underlying challenges and elements of sandbox design are mutually reinforcing. Since regulators are keen to minimise risks for end-users, the list of permitted activities within a non-authorisation sandbox is likely to be both (i) narrow and (ii) limited to areas where the risks

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40 See *Hayne Royal Commission* recommendations 6.9–6.10.

41 *APRA – ASIC Memorandum of Understanding* [12].

42 Ibid.

43 The ERS regulations do not establish reporting requirements, while *ASIC Information Sheet 248* includes only an *invitation* to provide a final report ('If you rely on the ERS exemption, please provide us with a short report within two months after the end of the exemption period').

44 Commonwealth, *Parliamentary Debates*, Senate, 6 February 2020, 370 (Jennifer Ryll McAllister).

45 'The 2017 Fintech Australia census reports that 9% of Australian fintechs plan to use ASIC's sandbox in the next 12 months': see ASIC, Submission to The Treasury, *Enhanced Regulatory Sandbox Proposal* (10 November 2017) 2.

46 Ibid 3.

are well understood. But if the underlying risks are already clear and/or immaterial, the regulators overseeing such a sandbox are likely to have little or no interest in having some kind of dialogue with the sandbox users in the first place.

4. Proposed solution: transition to an authorisation sandbox model

All of the above issues could be adequately resolved by *switching to an authorisation sandbox model*. This conclusion does not imply that an authorisation sandbox is the most efficient or desirable *per se*. Instead, it is submitted that the *past and current implementation* of the chosen (notice-based) sandbox model has been ineffective and inconsistent.

The design choices that would have worked well in an authorisation sandbox are out of place in the ERS. The gatekeeper entity (sandbox sponsor) was removed, but the gatekeeping function did not disappear – yet even if ASIC ends up being efficient in this role, the ERS procedures make FinTechs collectively worse off. ASIC's new powers suggest the regulator should have more control and engagement in the operation of its sandbox, and yet the benefits of the chosen notice-based model (including cost-saving) are likely to be maximised when the regulatory involvement remains minimal. Although the ERS has become substantially more complex (compared to the FLE), it has not offered FinTechs the tools available in similarly complex frameworks implementing authorisation-based access regimes (such as opportunities for a formal dialogue with the regulator within the sandbox framework).

Importantly, the statutory amendments introduced in February 2020 as part of the ERS are not linked to a specific sandbox model and empower ASIC to play a more active role in any sandbox framework. This means that a transition to an authorisation sandbox model *does not require* lengthy statutory amendments, although the May 2020 regulations (which follow the notice-based approach) are still in the way and would need to be revised to make possible a transition to the authorisation-based model.

Furthermore, given that it is the dominant sandbox format globally, the authorisation-based model of a FinTech sandbox will be much more *easily understood* by the end-users compared to the current puzzling – partially hands-on and partially hands-off – regime. A framework that is simple and clear would promote legal certainty and should be better aligned with ASIC's competition promotion mandate.