GROWING THE SANDBOX – AUSTRALIA'S ENHANCED FINTECH REGULATORY SANDBOX

After 10 months of operation, Australia's regulatory sandbox is entering a new phase. The sandbox provides a "lighter touch" regulatory environment to allow fintech businesses additional flexibility when they are still at the stage of testing their ideas. As flagged in its 2017-18 Budget, the Australian Government has released new draft legislation and regulations to create an enhanced regulatory sandbox to support innovation in financial services.

Key issues

- The Australian government released new draft legislation and regulations to enhance ASIC's regulatory sandbox for fintech start-ups.
- An eligible fintech company only needs to notify ASIC of its intention to offer products and services within the sandbox rules.
- ASIC's new conditional exemption powers are the most significant part of the proposed reforms.
- The reforms would also broaden the types of products that may be tested in the sandbox.

WHY THE CHANGES?

The first iteration of the sandbox was revealed by the Australian Securities and Investments Commission (**ASIC**) in December 2016. The sandbox is unique, an eligible fintech company only needs to notify ASIC of its intention to offer products and services within the sandbox rules. No further approvals from ASIC or other regulators are required and spaces are not limited, in contrast to other regulators' competitive models.

While an exciting development in Australia, the timing of the release and the relatively restrictive parameters of the sandbox to date has resulted in limited participation. By June 2017, only one startup had utilised the sandbox and as a result ASIC in that month released a consultation paper on further measures to improve the sandbox which appears to have informed the draft legislation. Hopefully the proposed changes will increase the attractiveness of the available exemptions.

At the end of this briefing we compare some of the key features of the regulatory sandboxes in Australia, Hong Kong and Singapore.

WHAT'S THE SAME?

For a fintech company to use the sandbox they:

- must not be banned from providing financial services and must not already hold an Australian financial services licence (**AFSL**) or Australian credit licence (**ACL**);
- must hold adequate public interest insurance and has implemented the required dispute resolution mechanisms; and

- may advise or distribute the following kinds of products (each with certain monetary limits):
  - deposit products;
  - payment products if issued by an authorised deposit-taking institution (**ADI**) (including non-cash payment facilities);
  - general insurance products (initially limited to certain kinds of general insurance);
  - liquid investments for listed Australian securities or simple schemes; and
  - consumer credit contracts with certain features.

Business are still limited to 100 retail clients (if providing financial services) or consumers (if providing credit) with no limits on the number of sophisticated clients and a total exposure limit across all clients of AUD 5 million.

WHAT'S NEW?

The key changes proposed are:

- extending the exemption period from 12 months to 24 months;
- amending regulations to enable ASIC to grant conditional exemptions to AFSL or ACL requirements for the purpose of testing financial and credit services and products;
- empowering ASIC to make decisions regarding how the exemption starts and ceases to apply;
- broadening the categories of products and services that may be tested in the sandbox; and
- imposing additional safeguards (see further details below).

EXEMPTION POWERS

ASIC's new conditional exemption powers are the most significant part of the proposed reforms. Currently regulations only provide for unconditional exemptions from AFSL and ACL requirements. The reforms also allow ASIC to effectively control how exemptions are granted and cease by granting the regulator decision-making powers.

NEW PRODUCTS

The reforms would also broaden the types of products that may be tested in the sandbox and loosen the monetary thresholds for some products, i.e. for general insurance products from $50,000 to $85,000 may be tested in the sandbox. New products include:

- life insurance products issued by a life insurer authorised by the Australian Prudential Regulation Authority (**APRA**);
- superannuation products issued by an APRA regulated superannuation fund;
- listed international securities (expanded from only listed Australian securities); and
- crowd-sourced funding activities within the new regime which came into effect on 28 September 2017.

ADDITIONAL SAFEGUARDS

The proposed regulations impose additional conditions for use of the sandbox exemption. They require fintech companies to clearly notify clients that they are using the exemption, are not an AFSL or ACL holder and that some of the normal protections that would be associated with receiving financial services or credit services will not apply.

These apply to both sophisticated and retail clients. For retail clients there are additional notifications required including information about a provider's remuneration, associations and relationships with issuers of products and the dispute resolution mechanisms available to clients.

At the same time certain baseline obligations continue to apply. For financial services these include obligations to act in a client's best interests, obligations on handling client money and on preparing statements of advice where personal advice is provided. For credit contracts these include responsible lending obligations, special rules for short-term contracts, limitations on fees and charges and unfair contract term rules.

Breaching these obligations may form the basis for ASIC cancelling a person's exemption. In addition, ASIC may cancel an exemption where they reasonably believe a person is not of good fame or character, or believes such cancellation is necessary given a person's failure to act fairly, efficiently or honestly.

WHAT'S NEXT?

Consultation on the package of reforms is in two stages: consultation on the exposure draft legislation ends on 3 November 2017 (which, unfortunately, is short like other recent consultations) and consultation on the exposure draft regulations ends on 1 December 2017. The new regulations will commence three months after they are registered (following passage of new legislation).

Accordingly, the expanded sandbox will likely only come into effect in early to mid 2018. Watch this space as ASIC and the Australian Government continue their efforts to support fintech in Australia.

REGULATORY SANDBOX COMPARISON – AUSTRALIA, HONG KONG AND SINGAPORE

Sandbox Features	**Australia**	**Hong Kong – HKMA (Supervisory Sandbox)**	**Hong Kong – SFC (SFC Regulatory Sandbox)**	**Hong Kong – Insurance Authority (Insurtech Sandbox)**	**Singapore – MAS**
When was the sandbox introduced?	December 2016	September 2016	September 2017	September 2017	November 2016
What products/services does the sandbox cover?	• Deposit and payment products • General and life insurance products • Superannuation products • Interests in simple managed investment schemes • Liquid investments in listed Australian and international securities • Certain consumer credit products • Crowd-sourced funding security	All fintech products and services and other technology initiatives intended to be launched in Hong Kong by banks (including innovative technologies such as mobile payment services, biometric authentication, blockchain, robotics and augmented reality).	All regulated activities under the Securities and Futures Ordinance (Cap. 571) (SFO), which includes: • Dealing in securities • Dealing in futures contracts • Leveraged foreign exchange trading • Advising on securities • Advising on futures contracts • Advising on corporate finance • Providing automated trading services • Securities margin financing • Asset management • Providing credit rating services	No maximum period has been prescribed. However, the authorised insurer is required to define the period for the pilot trial of a product or service before it is launched on a fuller scale.	No fixed exemption period, but the sandbox period must be a well-defined duration. At the end of the sandbox period, the legal and regulatory requirements relaxed by the MAS will lapse, and the sandbox entity must exit from the sandbox.
Who is eligible to participate?	To rely on the exemption, a person must not: a) be banned from providing financial services;	Authorised Institutions (as per the Banking Ordinance (Cap. 155)) and their partnering technology firms. Such institutions include	SFC licensed corporations and start-up firms that intend to carry on a regulated activity under the SFO. The qualified firm must be fit	Authorised insurers which are listed on the Register of Authorised Insurers maintained by the Insurance Authority (in accordance with	One of the sandbox evaluation criteria is whether the proposed financial products, services or processes ("**financial**

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	b) already hold an AFS licence or credit licence; c) already be an authorised representative of an AFS licensee that is authorised to provide the services covered by the exemption or already be a credit representative of a credit licensee; or d) be a related body corporate of an AFS licensee or a credit licensee.	licensed banks, restricted licence banks and deposit-taking companies which are listed under the HKMA Register of Authorised Institutions and Local Representative Offices.	and proper, utilise innovative technologies and are able to: demonstrate a genuine and serious commitment to carry on regulated activities; increase the range and quality of products and services for investors; and benefit the Hong Kong financial services industry, through the use of fintech. Start-up firms seeking to make use of the sandbox need to apply for and obtain the appropriate licence and comply with the applicable requirements (including financial resources requirements).	the Insurance Ordinance (Cap. 41)).	**services**") include new or emerging technology, or use existing technology in an innovative way. MAS has advised that the sandbox may not be suitable where the proposed financial service is similar to those that are already being offered in Singapore, unless the applicant can demonstrate that either a different technology is being applied, or the same technology is being applied differently. MAS has also advised that the sandbox may not be suitable where the applicant has not demonstrated that it has done its due diligence.
What is the exemption period?	12 months – with a proposed extension to 24 months	No maximum period has been prescribed. However, the authorised institution is required to define the period for the pilot trial of a product or service before it is launched on a fuller scale.	There is no specified time period. Once the company has demonstrated that its technology is reliable and fit for purpose, and its internal control procedures have adequately addressed the risks identified, then it may seek removal or variation of	No maximum period has been prescribed. However, the authorised insurer is required to define the period for the pilot trial of a product or service before it is launched on a fuller scale.	No fixed exemption period, but the sandbox period must be a well-defined duration. At the end of the sandbox period, the legal and regulatory requirements relaxed by the MAS will lapse, and the sandbox entity

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			some or all of the licensing conditions imposed so that it may conduct regulated activities on the same basis as licensed corporations which operate outside the sandbox.		must exit from the sandbox.
Are there financial limits on businesses?	Yes – total exposure limit of AUD 5 million	No.	No. Although the SFC may impose licensing conditions which may include restricted exposure of clients.	No.	No – sandbox applicant required to indicate proposed quantifiable limits, such as transaction thresholds or cash holding limits, in its application.
Are there client number restrictions on businesses?	Yes – maximum 100 retail clients, no limits on the number of sophisticated clients	Limited number of participating customers (such as staff members or focus groups of selected customers). However, a ceiling has not been specified.	SFC may prescribe limits upon the number and the types of clients which the company may serve.	Authorised insurers are required to specify the targeted users when they seek approval. This may include external customers and/or selected group of staff of the authorised insurer.	No – sandbox applicant required to indicate proposed target customer type and limit on the number of customers involved in its application.
How does a business apply to use the sandbox?	A business only needs to notify ASIC of their intention to offer products and services within the sandbox rules	Businesses are required to seek HKMA approval prior to being able to offer products and services under the sandbox rules. The HKMA generally provides them with individually tailored supervisory flexibility that can	Prior approval by the SFC is required. To the extent that the SFC considers an applicant for a licence to be able to benefit from the sandbox rules, SFC would propose such an arrangement from its end.	Businesses are required to get in touch with the Insurtech Facilitation Team set up by the Insurance Authority and have their application for the Insuretech initiative approved prior to being able to make use of the	Prior to submitting an application, an applicant should clarify any questions it has with the MAS. Upon receipt of an application, the MAS would review the application and endeavour to inform the applicant of its

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		be made available to them within the sandbox rules.		sandbox rules.	potential suitability within 21 working days after the MAS receives all of the information required for its assessment. If deemed potentially suitable, the MAS would evaluate the application further. If the application is approved, the sandbox would be launched into the experimentation stage. The sandbox entity would need to notify its customers that the relevant financial services are being operated in a sandbox and disclose the key associated risks, and also obtain customers' acknowledgement that they have read and understood the risks.
Any other notable features?		The following new features are being considered by HKMA: (i) a Fintech Supervisory Chatroom will be set up to provide supervisory feedback to banks and Tech firms at an early stage of the development of their fintech		Companies may be placed under closer monitoring and supervision by the SFC when they operate in the sandbox.	

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		products; and (ii) tech firms may have access to the sandbox by seeking feedback from the Chatroom without necessarily going through a bank.			

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