



SUBMISSION PAPER

APRA LICENSING DISCUSSION PAPER

# **A new phased approach to authorising new entrants to the banking industry**

**December 2017**

*This Submission Paper was prepared by FinTech Australia working with and on behalf of its Members; over 180 FinTech Startups, VCs, Accelerators and Incubators across Australia.*



## Introduction and Background

FinTech Australia and its members welcome the opportunity to provide feedback to APRA regarding their licensing discussion paper on a new approach to authorising new entrants to the Banking industry.

Below we summarise feedback on behalf of FinTech Australia's Bank Licensing and Neo-banking working group, as well as others outside of FinTech Australia's membership who are currently in the process of, or planning to undertake a new license application.

### **Introduction of phased approach for ADIs**

*Should APRA establish a phased approach to licensing applicants in the banking industry?*

Yes. FinTech Australia strongly believes APRA should establish a phased approach to licensing applicants in the banking industry in order to provide a clear pathway for new, innovative fintech companies to pursue if they wish to obtain an ADI license.

Based on our observations of the implementation of FinTech Regulatory Sandboxes across the world (including Australia), making some form of restricted early testing phase available for new entrants does more than simply create a pathway. It also sends strong signals to market that Australia's regulators are willing to engage with new industry entrants, so as to create viable, sustainable and legitimate businesses that may enhance the competitive landscape to the benefit of consumers and the broader Financial Services Industry.

Whilst APRA already has the power to grant conditional licenses or waivers for new entrants, matched with graduated capital requirements, this pathway has not been clear to industry in the past. The implementation of this new phased approach will encourage (or indeed has already created) a new wave of interested parties that will seek to obtain an ADI license through this new licensing pathway.

### **Balance of APRA's mandate**

*Do the proposals strike an appropriate balance between financial safety and considerations such as those relating to efficiency, competition, contestability and competitive neutrality?*

Yes. FinTech Australia believes the proposals strike a good balance, particularly in relation to competition and facilitation of new entrants in a manner that ensures they are tasked with creating good governance frameworks and risk reporting capabilities as they develop in the early restricted licensing phase.

### **Eligibility**

*Are the proposed eligibility criteria appropriate for new entrants to the banking industry under a Restricted ADI licence?*



Yes, FinTech Australia believes the eligibility criteria are generally appropriate for new entrants to the banking industry, i.e. those who may be seeking to start from scratch to obtain a new ADI license and having not previously undertaken any activities relating to the provision of financial products and services.

However, we recommend that APRA provide further clarification and guidance regarding activities that they view as being “low risk” as opposed to “high risk”. This is of particular note given some fintech startups may wish to also use this pathway to obtain an ADI license for low-risk activities, for example gaining access to Payments infrastructure to provide payments, without intending to offer riskier lending products.

It is also noted however that longer-term, these companies, and others who may have other license types such as an AFSL or ACL and have a long-standing existing and mature operations, may also wish to make use of the Restricted ADI License phase. Should the policy intent be to encourage innovation and competition that benefits consumers whilst still ensuring that adequate safeguards and consumer protections are in place, those who have already exhibited they are capable of creating sustainable, compliant organisations may be regarded as lower risk, and thus not discouraged from undertaking the process of becoming an ADI to branch out into other product offerings should they wish.

To that end, FinTech Australia posits that a second and separate type of Restricted ADI Licensing pathway may also be required, in addition to the current proposed pathway for new startup businesses. In this case, some of the initial eligibility requirements, for example some aspects of Governance, Business Plan and Fit and Proper assessments could be designed to be less onerous than for those who are starting from scratch.

Furthermore, FinTech Australia also stands by its original recommendation that APRA also create an Innovation Hub within their Licensing team that will help companies with new, innovative business models - some which may not yet have even been considered - to find the right person at APRA with which to discuss their plans, and obtain further direction. This model has proven extremely effective at ASIC and other jurisdictions in supporting the successful and safe development of new innovative fintech products and services.

FinTech Australia would be happy to discuss further with APRA any ideas and approaches to how this additional pathway, or Innovation Hub might operate.

### **Restricted ADI Licence phase**

*Is two years an appropriate time for an ADI to be allowed to operate in a restricted fashion without fully meeting the prudential framework? Is two years a sufficient period of time for a Restricted ADI to demonstrate it fully meets the prudential framework?*



FinTech Australia believes that the maximum of 2 years proposed may be too short, particularly given the relatively high expense of human capital, the limited funding environment in Australia, and the difficulty many startups would face in obtaining the requisite \$3m in capital plus wind-up costs.

Consultation with FinTech Australia members, and some Neo-banks currently investigating the new licensing pathway, suggest that a new startup Company would need to raise between \$5-7m in Capital to meet the requirements, of which \$3m would be the required APRA reserve. The remaining \$2-4m is our best estimate as to the cost of operational resources, legal fees etc which would be required in order to build both the technology platforms for testing customer appetite for the new ADI's products, as well as the policy, risk and governance frameworks required by APRA within the 2 year timeline to build and deploy the Bank.

This level of capital is already hard enough to come by, notwithstanding the fact that would take valuable time away from the senior management team (approximately 6 months per capital raise) who otherwise would be working to deliver the other technology and governance milestones to APRA.

FinTech Australia proposes that the maximum timeframe be extended to 3 years, and/or, for the implementation of a mandatory mid-point check with APRA at about the 1.5 to 2 year point, where APRA could give a 1 year extension to the company based on where they were in the process.

This check, together with the possibility of an extension would mean less time pressure on startup founders, ensuring they can stay focused on running operations smoothly rather than a fast-coming cut-off deadline. It also creates more certainty for Investors - a longer time-horizon could also allow for a second capital raise if it was required, particularly given investors would more likely invest in stage-gates such as when the startup was granted the restricted license, and again at the APRA extension.

Finally, the check-point would also help APRA get a sense of the Company's progress toward establishing the required risk frameworks needed to progress to the next stage, i.e. a full license with conditions. At this point, APRA could give the company much-needed feedback as to any deficient areas that need to be addressed if there are any.

## **Minimum requirements**

*Are the proposed minimum requirements appropriate for potential new entrants to the banking industry? Are there alternative requirements APRA should consider?*

Yes, FinTech Australia believes these minimum requirements are appropriate.

## **Licence restrictions**



*Are the proposed licence restrictions appropriate for an ADI on a Restricted ADI licence? Are there alternative or other restrictions APRA should consider?*

It is FinTech Australia's view that the \$2m aggregate limit on FCS eligible deposits is too low. This is further discussed under the below section relating to FCS.

FinTech Australia would also like to see the removal of, or further clarity around the restriction posed under *4.3.5 Restricted ADI License: Capability development and testing*, specifically in relation to a Restricted ADI being "not expected to be actively conducting business with the general public".

Restricted ADIs will inevitably need to test with end customers beyond friends and family to obtain the best understanding of whether their products are appropriately designed and operational, even if in small numbers. The other restrictions imposed by the proposed capital and aggregate deposit limits are designed to ensure that any early customers, whether from friends and family or beyond that to early adopters of the general public, are protected.

As such, FinTech Australia believes that the restriction on Restricted ADIs to not actively conduct business with the General Public should be lifted, or clarified as to differentiate between testing with select early and consenting members of the General Public such as early adopters, as opposed to marketing products at a mass scale which would inevitably put the ADI beyond its aggregate deposits cap.

## **Financial Claims Scheme**

*Are the proposals appropriate in the context of the last resort protection afforded to depositors under the Financial Claims Scheme?*

FinTech Australia proposes that the \$2m aggregate limit on FCS eligible deposits is too low. This is particularly true of neo-banks that are seeking to target Business customers as part of their primary market - in this case, the aggregate would be almost impossible to stay within given the high deposit amounts likely to be seen for even small businesses.

Should a Neo-bank then surpass this limit due to unforeseen better than expected demand (in which case they wouldn't yet have all their required processes in place), there is no clear pathway for them to resolve this with APRA proposed in the paper.

As such, FinTech Australia recommends that the aggregate limit be lifted to \$5m, and/or potentially the creation of separate individual and aggregate customer deposit limits for Consumer and Business accounts. Given the pathway from a Restricted license to a conditional license would still require a 20% MLH, the initial \$3m capital requirement would still stay within the required ratio.

## **Further refinement**

*Are there other refinements to the licensing process APRA should consider?*



FinTech Australia would like further clarification in relation to the required License application fees in the context of both the Restricted ADI License as well as the Conditional license. The \$80K up-front fee may prove high for some startups, though would be more considerate if this was not also then required again upon application for their full or Conditional license.

Should the mid-point check proposed by FinTech Australia be put in place, we recommend that the License application fee be split between these two points; namely \$40K at the initial application, and the remaining \$40K at the check for possible subsequent extension (or, at the time of their application for a full or conditional license should they proceed before the check).

FinTech Australia also recommends that further guidance be given regarding the process surrounding transitional arrangements toward a conditional ADI license.

As previously highlighted, it is not commonly known outside of APRA that a process already exists with respect to allowing a graduated capital requirement. Further clarification on this in supporting regulatory guides would be welcome, and would also ensure that companies can also potentially be better informed in their approach to APRA when they are preparing for their transition out of the Restricted Licensing phase.

Finally, FinTech Australia is also supportive of APRA having improved mechanisms to exit or transition out any underperforming ADIs, whether they be in the Restricted Licensing phase, conditional ADI license or full License. This will ensure the market remains competitive, and those providing the best products for the customer can operate profitably given our relatively small market, and the current high perceived cost of switching main financial institution.

## **Conclusion**

FinTech Australia strongly welcomes the new Restricted Licensing pathway proposed by APRA. In conjunction with the proposed changes to Financial Sector (Shareholdings) Act to relax the 15% threshold for substantial shareholders in ADI's, the proposed changes are already stimulating a robust level of interest from some extremely capable and viable new potential digital challenger banks.

It is our belief that many innovative new challengers will benefit from this new pathway, and from being able to successfully test their new services with Consumers. In close consultation with APRA, ideally via some form of Innovation Hub or at least via the Licensing team, they will also be able to create the robust risk and compliance frameworks needed to operate in Australia's world-class Regulatory regime, creating a positive step-change in Customer experience, and delivering powerful new products and services that will potentially benefit many Australians.