COLIN BIGGERS & PAISLEY
LAWYERS

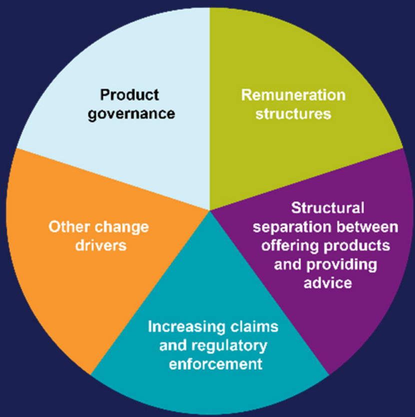
FINANCIAL SERVICES IN AUSTRALIA

Insights into regulatory priorities and market developments, emerging trends and risks for 2021

CONTENTS

INTRODUCTION

The year of the pandemic—2020—witnessed key and strategic product and operational shifts across a range of financial services sectors primarily arising from the confluence of financial stress, customer retention risk, the pandemic as a catalyst for further digitalisation and technological innovation, and increasing regulatory change and pressures resulting from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission).



These trends will continue into 2021 and beyond and will impact banking, payments, wealth management, insurance, and managed funds.

In this report, we analyse these changes and likely regulatory priorities with a view to identifying new developments within relevant sectors and emerging legal and market risks which financial services issuers, providers and participants will need to consider in 2021.

We discuss a number of topical issues facing the financial services industry in 2021, including how the regulatory landscape and ASIC's enforcement policy has led to a significant increase in claims and investigations, the decrease in the number of registered financial planners and AFSL applications, changing remuneration arrangements, the emerging regulatory risk for financial product design and distribution, technological responses to secure customers and expand markets, managing customer risk, global convergence of regulation and markets, licensing foreign entrants into Australia, and regulatory responses to advances in technology, particularly in payments and financial advice.

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WEALTH MANAGEMENT

Recently we have seen a wholesale retreat from the wealth management sector with NAB selling out of MLC, IOOF acquiring ANZ's pensions and investments business and Westpac selling its loss-making financial advice business to Viridian. This represents a general continuing response by the banks in light of the Banking Royal Commission to divest acquisitions of financial planning and wealth management business which occurred in previous economic cycles and to mitigate regulatory risk.

At the same time, we have seen a consolidation of many financial adviser groups.

It poses the question: what trends are emerging in banking, wealth and financial planning and what are the risk implications from these market shifts?

Independent revolution in financial advice that has coincided with the Hayne Royal Commission and the exit of the banks is structural, not cyclical.

- There has been a move away from vertical integration, where firms offer both financial advice and financial products in a system of intertwined cross-subsidies and incentives, along with the recently banned model of paying commissions that was undermining the industry's ability to service customers well and keep their trust.
- Offering professional services and conflict.
- It also highlighted the issue of conflicted versus independent advice and conflicted remuneration.

The change is complex and driven by a range of factors:

- Hayne Royal Commission
- Regulatory change
- Quarantining of risk
- Profit and margin

Exit of the banks

- The bancassurance trend in the early 2000s saw the big four banks (Commonwealth Bank, Westpac, ANZ and NAB), as well as Macquarie, AMP and IOOF acquiring independent financial planning dealerships, keen to use them to distribute their growing suite of investment and insurance products.
- Banks sought to compete against superannuation.
- Exit of the major banks has seen the incidence of vertical integration in the wealth management sector also reduced, with only the likes of AMP, IOOF, the remnants of Colonial First State and Fiducian still holding to recognisably vertically integrated models.

INDUSTRY POST-HAYNE ROYAL COMMISSION

The financial services industry faced serious scrutiny in the Hayne Royal Commission. The Australian Securities and Investment Commission (ASIC) revealed that 90% of financial advisers providing advice to self-managed superannuation funds failed to comply with the best interests of their clients and that it did not believe the financial advice industry was a "profession" yet because it had not reached the standards of a profession.

Has the financial services industry learnt its lesson?

The Hayne Royal Commission has been a turning point for growth. From the fallout, major industry players have recognised issues in conduct, where practice was well below the standards expected by the public, government, regulators and the financial advice sector. The industry has been able to take this on board and change its client experience.

Equally, there has been significant change to the regulatory framework. The changes appear to be driven by a combination of regulatory factors including ASIC reporting on the quality of financial advice (based on a limited review) with concerns identified and most importantly through the legal changes to the regulatory framework for financial advisers. In particular, a best interests duty and a ban on conflicted remuneration applies under the Future of Financial Advice (FOFA) reforms.

In adapting to these reforms, new business models are emerging. The regulatory and legislative changes are designed to address causes of behaviour. Ideally, these changes will have the effect of improving consumer engagement and our observation is that it is having this effect. The financial advice sector must now benchmark its operations to a new professional and regulatory standard that is more rigorous than before. The challenge is how to transition from past arrangements.

It is notable that in ASIC report - ASIC Report 639 - Financial advice by superannuation funds - released in December 2019, the key identified conflicts of interest in the provision of financial advice in the superannuation industry were vertical integration, relationships with third-party advice providers, and bonuses paid to advice providers.

In this regard, it is likely that financial planning businesses that focus on consumer engagement and which integrate the new standards within their governance frameworks will do better.

Financial Adviser Standards and Ethics Authority (FASEA) restructure

The financial advice sector regulatory reforms included the establishment of a Financial Adviser Standards and Ethics Authority (FASEA). The Federal Government announced late last year that FASEA will now be assimilated by Treasury and ASIC. In summary:

- The Government will give effect to this recommendation by expanding the operation of the Financial Services and Credit Panel (FSCP) within ASIC.

  > *The FSCP currently supports ASIC in the exercise of its regulatory functions with respect to the making of banning orders against individuals for misconduct.*
  >
  > *Expanding the role of the FSCP will leverage its extensive expertise and existing governance structures, avoiding the need to establish a new body to perform this role.*
  >
  > *Consolidating this new function within ASIC will also avoid regulatory overlap and minimise the possibility of multiple investigations by multiple agencies into the same conduct related to the provision of financial advice.*

- The Government will also move the standard-making functions of FASEA to Treasury.

The expanded regulatory function of ASIC is likely to be perceived by the financial advice sector as a stronger regulatory position than an independent standards and ethics body (which was FASEA).

A PEOPLE-FOCUSED INDUSTRY

At its core, financial services operates and succeeds because of its people. The people and governance risks are evolving.

What might the people and governance risks be for the industry moving forward?

In an industry sector adapting to regulation, key people and governance risks include:

Rise of rule and regulation-savvy consumers

- Access to and transparency on rules and regulation in the industry have substantially increased, which in turn has knock on impacts for providers.
- Increased complaints as consumers become more sophisticated in their knowledge and understanding of the potential avenues for redress.

Industry and knowledge movement

- There has been recent extensive movement of participants within the financial services sector, and loss of both senior members of staff as well as other support staff carries with it the loss of corporate knowledge and understanding.

Regulator and plaintiff activity

- Increased activity by the regulator and plaintiff firms carries with it both financial and reputational risks. However, increased scrutiny will lead to changes in governance and internal processes, which will most likely have positive outcomes for consumers.

FUTURE LEGISLATIVE REFORMS

ASIC has a specific focus on and concerns with remuneration in the financial planning industry.

What potential is there for further legislative reform in this area or enforcement action by ASIC?

It is fair to say that the IFA industry in Australia has been driven in waves caused by structural changes and new investments products.

The conflicted remuneration rules have taken effect, and it remains to be seen how the recent "professionalisation" drive will have an effect on payment and remuneration arrangements.

- Complex commission arrangements have previously been scrutinised by ASIC (for example, refer to the ASIC enforcement actions mentioned below) and legal proceedings commenced where ASIC considers a remuneration arrangement to be contrary to the ban on conflicted remuneration.
- Currently exemptions apply for certain remuneration in connection with life risk insurance products. The Hayne Royal Commission recommended ultimately reducing such commissions to zero, however, we do not expect there to be an immediate change in the regulatory process to achieve this as ASIC's focus is likely to be on other regulatory priorities.

Of further interest is whether the Banking Executive Accountability Regime that currently applies to ADIs is to be rolled out into other key financial product areas, which in turn may prompt consideration of alternative remuneration models which align incentive with risk.

By way of background, an ASIC summary of fees for no service investigations and outcomes is linked here.

Other recent key ASIC enforcement actions in relation to conflicted remuneration are:

Westpac

- 19-293MR ASIC wins appeal against Westpac subsidiaries.

Commonwealth Bank

- 20-143MR ASIC sues CBA and Colonial First State for payment of banned conflicted remuneration.

BT Funds Management and Asgard Capital Management

- 20-190MR ASIC commences civil penalty proceedings against BT Funds Management and Asgard Capital Management for charging fees for no service and misleading statements.

EMERGING PRODUCT ADVICE STRUCTURES

How can product and advice conflict be managed going forward?

It is important to note that the Commissioner in his report on the Hayne Royal Commission did not recommend that there should be structural separation between offering products and providing advice, but instead recommended various strategies for avoiding conflicts. The recommendations add to the FOFA reforms and provide increased transparency around the interaction between the advice arm and the product arm of a business.

In particular, the Commissioner warned of the perils of a "one-stop shop" and recommended that a five-year review be undertaken by the Australian Competition and Consumer Commission on this matter.

Coupled with product governance obligations, in our view the key to addressing the emerging financial advice risk is to, at least, ensure there are checks and balances in place to identify and manage conflicts. In essence, consumers need to be given a choice of provider, an explanation of the choices and why one product has been recommended over another, so that they may make an informed decision.

The retirement sector

In August 2018, ASIC published its review of reverse mortgage lending. Although it has only been a short time since the review, much has changed socially and economically. Financial institutions continue to innovate in order to service the retirement sector.

In our view, ASIC will continue to have a strong focus on the retirement sector as financial products and services develop to service the sector. Financial institutions must ensure they comply with the legal and regulatory obligations under the reverse mortgage regulatory regime for credit contracts (or "credit products") incorporating reverse mortgage configurations or the financial services regulatory regime when reconfiguring innovative financial products and services directed at the retirement sector.

Custody arrangements and investment opportunities across the distributed ledger technology space continue to evolve and we are seeing a strong need for innovators to obtain peremptory financial services regulatory advice.

TECHNOLOGY-DRIVEN CHANGE

Given the increasing regulatory and market constraints on remuneration, one popular alternative emerging in the independent financial advice industry is the bifurcation of the advisory model to include robo-advice directed at a major segment of financial planning customers on a pay-per-service basis for those who can afford it.

Is this alternative model viable?

We have witnessed an increasing number of our clients turning to technology as an enabler to increase customer portfolios and customer accessibility to products, including platform solutions.

Technology is often seen as a way to reduce costs as it allows for a greater efficiency and scope.

Whilst the current market focus is on providing "affordable services", that outcome is not certain.

Fintech and technology drivers are diverse and include: de-aggregation, gaps in the market, digitalisation, platforms, cost, COVID-19, cross-border and algorithms and apps.

Are there potential problems with the technology approach?

Technology integration is highly evolving in financial institutions.

An inherent complication with technology is that its success can be subject to the suitable implementation by the user. This means new technology isn't always the solution to an operational or client risk and similarly for market growth (for a sell side arrangement).

The current regulatory framework can also hinder (rightly or wrongly) new technology providers and products. For example, robo-adviser Plenty Wealth was shut down in October 2019 after the intervention of the regulator (ASIC), with its founder saying the current laws made the product "unworkable".

In the context of the financial advice sector, technology can be seen as an enabler of advice, drive lower costs for services regarding SOA/ROA, provide better efficiency and availability, and economies of scale to the service market.

ASIC has acknowledged that robo-advice can be an asset to consumers, but it has also identified problematic issues inherent in the shift and specifications of digital advice. In response, ASIC has issued a regulatory guide - [Providing digital financial product advice to retail clients](#).

What are the risks to be aware of?

Transition to technology solutions and an increasing reliance on technology by issuers and users has resulted in a trend of increasing overall risk. Key risks for financial services are:

- systemic
- magnitude
- cyber security
- money laundering
- global nature and enforcement
- fraud and organised crime
- platforms - Know Your Customer - governance

Examples where digital advice has been utilised include:

- the superannuation sector, which has been well advanced in introducing wealth "calculators" for a number of years
- automated trading, including copy trading, has been implemented, as well as token based asset holding arrangements
- big data is influencing comparison tools, as well as new products such as digital currency

DIGITAL STRATEGY

The events of 2020 in which COVID-19 forced a transition to remote communications were catalysts for the digital transformation that had already begun for business, government and regulation. In 2021 we expect the binary focus to continue.

Current situation with (regulator) suptech and regtech?

For financial institutions, we expect suptechnology will eventually be phased in by regulators and from a global perspective it is expected to form a key part of a regulator's tool kit. This is likely to result in a closer relationship and focus on data and IT strategy for a business with its regulators, and at some point could lead to increasing compliance costs to effect the necessary change to satisfy regulatory obligations. Whilst the actual impact is unclear and uncertain, potential impacts which have been mooted are:

- a shift to a “data-sharing” concept and for the “data-sharing” concept to become a reality, the right technology and data standardisation are critical
- the size of a financial institution, its business model and the resources allocated to deal with regulatory reporting can also make the regulatory reporting process more complex
- weaknesses in technological infrastructures and data architectures. During the global financial crisis (GFC), this was problematic for data aggregation by large financial institutions. Many were unable to aggregate risk exposures and identify concentrations fully, quickly and accurately (there is still a regulatory perception that this issue remains)
- COVID-19 identified serious limitations to enhanced off-site monitoring by regulators, as upgrades were required to existing data requirements, to enable the receipt of specific reports at higher frequencies and to enable responses to new ad hoc data requests

Cybersecurity normative

Cybersecurity in the digital age is now a standard risk that financial institutions (as well as other businesses) must address. As digitisation increases, the need to address this risk is likely to grow and increase in complexity.

Too big to fail?

Interestingly, one assessment of the GFC was that the regulatory regime for financial institutions deemed certain institutions too big to fail. Similar ethical, systemic, contagion and governance risk arises in the context of technology businesses and platforms, particularly in certain settings such as data security and infrastructure (e.g., cloud server providers, cybersecurity).

Digital advice

In Australia, the provision of digital financial advice is considered by ASIC to have grown rapidly and ASIC expects this to continue. As an example, areas where digital advice has been implemented include, portfolio construction services for a client, investment recommendations for a client, investment and financial product return calculators, and automated and robo-advice which run algorithms. Technology innovation and "big data" may continue to drive development in data analytics and the provision of financial advice and, in our view, will increasingly come under regulatory scrutiny as the sector evolves.

In the context of robo-advice, some of the main technological and regulatory risks to be aware of include:

- Robo-advice, like any technology, requires suitable implementation and monitoring. If not suitably managed, disastrous outcomes can result. For example, the high frequency trading flash crash was algorithm based and originated remotely.
- Technology also has cross-border reach, which introduces foreign regulatory compliance risk as it gains customers in different countries.

- There is also a risk of unlicensed activities. There is a significant tech-driven side to robo-advice but developments are unfamiliar with financial services regulatory regime.

ASIC RG 255 deals with providing digital financial product advice to retail clients.

PRODUCT GOVERNANCE

The design and distribution obligations are on the doorstep and planning has started.

The product design and distribution obligations require firms to design financial products to meet the needs of consumers, and critically, to distribute their products in a more targeted manner.

The obligations were due to commence in April 2021 but in May 2020, ASIC announced that it would defer the commencement of the design and distribution obligations by six months due to the serious impact of COVID-19 on the Australian economy.

When the legislation comes into effect, financial advisers will be subject to further regulatory red tape in the process of engaging and complying with the design and distribution obligation, albeit probably not strictly as a "distributor" (a distributor has a broad definition and includes an Australian financial services licensee, authorised representative, credit licensee and credit representative, so a financial adviser and credit intermediary within the definition).

Technology innovators in the financial services sector will need to seriously consider the target market determination (TMD) and "distributor" obligations under the regime, as the distribution pipeline requires reasonable steps to be taken so that retail product distribution conduct is consistent with the TMD.

Given increasing activity and innovation in the digital currency market, if a cryptocurrency and its underlying asset falls within the financial product category, then applying the design and distribution obligations could present some interesting challenges. On 11 December 2020, ASIC issued RG 274 Product design and distribution obligations - regulatory guidance here.

COMPLAINTS HANDLING

A key risk for consideration in a period of economic downturn is complaints and claims against a financial institution.

What sort of claims are being experienced and in what forums are those claims being commenced?

AFCA is often the venue of choice now for claimants.

The vast majority of complaints in AFCA last year arose from financial advice provided with respect to derivatives and hedging/gearing (47%), followed by managed funds (30%) and then superannuation non-trustee (i.e. SMSFs) (22%).

Of note, in the past year there has been an increase in the number of superannuation complaints, a trend which may continue due to the wealth held in the sector, the general shift to a retirement phase (e.g., baby boomers retiring) and recent market volatility.

On the other hand, the split between complaints from consumer loans, credit cards, housing finance and deposit taking/payment systems is relatively even with no frontrunners.

The AFCA Financial Year 2019-20 Snapshot can provide further detail.

IOSCO issues sound practices guidance to assist members in improving complaint handling and to protect retail investors

A recent international regulatory report for dispute resolution is the IOSCO report "Complaint Handling and Redress System for Retail Investors". The report coincides with the updated guidance for internal dispute resolution schemes issued by ASIC in mid-2020.

The IOSCO report provides some useful insights into complaints handling across a number of sophisticated financial markets. For example, when asked to list the top complaint categories received in the last year, participating jurisdictions collectively answered as follows:

- fraud (advance fee fraud, offering fraud, market manipulation, high-yield investment schemes and cross-border fraud)
- sales practice issues (mis-selling of products and services, unauthorised transactions, inadequate fee or product disclosure, and inappropriate and/or unsuitable advice)
- operational issues (account administration issues, delays in order execution, late payment of sale proceeds, and IT/technical issues), and
- performance issues (product, fund, portfolio and account)

Financial institutions planning their risk and compliance arrangements may find the report provides a useful reference point on what to manage for potential client and regulatory issues going forward.

SOLVENCY AND COMPENSATION

A compensation scheme of last resort was tabled in the Hayne Royal Commission.

What is the current state of play?

The Hayne Royal Commission recommended the establishment of a Compensation scheme of last resort. Government is still to implement the scheme.

AFCA supports a last resort compensation scheme which is especially relevant where complaints are in respect of an insolvent financial institution (given certain constitutional issues relating to the status of AFCA). AFCA's current position for insolvent insureds is that it has paused processing complaints against insolvent insureds during COVID.

The Federal Government released a discussion paper on establishing a compensation scheme of last resort in December 2019. The scheme, to be industry funded, was due to be legislated by the end of 2020. However, the Treasurer has announced that due to the impact of COVID-19, measures originally scheduled for introduction by December 2020 will now be introduced by 30 June 2021.

Remediation plans

ASIC is proposing to extend the application of its current remediation policy for financial advisers to all Australian financial services licensees and credit licensees. The proposed policy is set out in consultation paper 335 and has the following timetable:

- Stage 1: 3 December 2020 - ASIC consultation paper released
- Stage 2: 26 February 2021 - Comments due on the consultation paper
- Stage 3: To be advised - Draft regulatory guidance released for further consultation

Remediation, on top of the regulatory action that precedes it, is a serious matter for a financial institution to address and can represent significant commercial value. In its media release for the consultation, ASIC states that it is currently monitoring over 100 remediations that could see the return of at least another $3.55 billion in total to over 3.6 million consumers upon finalisation.

Risk, governance and compliance systems and procedures are critical areas to manage for suitable remediation. The consultation paper reflects this.

ASIC'S "WHY NOT LITIGATE" POLICY

We have seen a significant increase in ASIC's enforcement activity over the last 12 months or so with the number of investigations commenced by ASIC increased by 11%.

ASIC saw a 48% improvement in the time taken to commence civil penalty proceedings, and did not accept any court enforceable undertakings and is instead "focusing on accelerating court-based enforcement outcomes". There was also a 100% increase in the total civil penalties imposed, with ASIC having a 97% success rate in civil actions in FY20.

What effect has ASIC's new "why not litigate" policy had and what are ASIC's internal drivers likely to be?

ASIC's set of regulatory tools includes enforcement, product compliance and disclosure.

In this regard, the product intervention power mentioned above is a key component in ASIC's regulatory armoury going forward. Market conduct can also be regulated through a strong regulatory policy for supervision and enforcement.

The emphasis on a "why not litigate" approach arose as a result of the Banking Royal Commission recommendations and evidence that negotiated regulatory outcomes, such as enforceable undertakings for some misconduct, were not enough of a deterrent and were not constructively influencing or changing recalcitrant market behaviours or institutional behaviour.

ASIC's track record of "why not litigate" does not automatically mean a court's decision will be favourable to ASIC.

Westpac

- Westpac responsible lending - responsible lending law under which ASIC prosecuted Westpac – contained in section 128 of the *National Consumer Credit Protection Act*.
- An unfavourable outcome for ASIC with the infamous reference to a person being able to change their consumption of Wagyu and Shiraz (note, this should be contrasted with a person being incorrectly assessed as being financially capable of consuming Wagyu and Shiraz).
- Responsible lending regulatory reform has been subject to a different regulatory focus during the COVID-19 economic period.

NAB

- Fees for no service - NAB's wealth management division ordered to pay a total $57.5 million penalty after the Federal Court of Australia found that NULIS Nominees (Australia) Limited (NULIS) and MLC Nominees Pty Ltd (MLC Nominees) made false and misleading representations to superannuation members about their entitlement to charge plan service fees and members' obligations to pay the fees. The Court also made declarations that MLC Nominees and NULIS failed to ensure that their financial services were provided efficiently, honestly and fairly.

ANZ

- No same-name fees - The Federal Court of Australia ordered that Australia and New Zealand Banking Group Limited (ANZ) pay $10 million in penalties after finding that ANZ engaged in unconscionable conduct and breached its obligations as a financial services licensee by charging fees to customers it was not entitled to charge and then by failing to remediate those customers.

CBA

- AgriAdvantage Plus Package - The Federal Court of Australia ordered CBA to pay a $5 million penalty after the Court found that CBA had breached the *ASIC Act* and *Corporations Act* for failures of their AgriAdvantage Plus Package (AA+ Package); the failures being that customers were overcharged fees and interest on loans and fees, and underpaid interest on savings. CBA's failures included the highly manual nature of its systems. ASIC considered that CBA's conduct, which was examined in detail during the Banking Royal Commission, was the result of inadequate systems and processes and because of its conduct, CBA failed to deliver its AgriAdvantage package efficiently, honestly and fairly.

AFS Licensees

- Licensees who fail to ensure their financial services are provided "efficiently, honestly and fairly" as required by section 912A of the *Corporations Act*. For example, any dishonest, misleading and deceptive conduct by those providing financial advice or services, market misconduct that threatens to create uncertainty and erode investor confidence. It is not easy to litigate against highly sophisticated financial institutions which are experienced in dealing with the complex regulatory framework of the Australian financial services industry, despite what might have been suggested by the examination of specific case studies at the Royal Commission.

Regulatory intervention powers

- Regulatory intervention powers against financial institutions, including requiring enhanced reporting and independent audits or restricting product offerings.

The *Stronger Regulators Act*, which commenced on 18 February 2020, aims to:

- harmonise and enhance ASIC's search warrant powers
- improve ASIC's ability to access telecommunications intercept materials
- extend ASIC's banning powers
- strengthen ASIC's licensing powers

Enforcement is likely to be a key focus for the future direction of ASIC's regulatory action related to deterrence.

However, given the mixed results of its switch to a "why not litigate" policy to date, we suspect that it would be better for ASIC to strike a balance by conducting an assessment of how litigation can be best deployed and then implementing a targeted approach, in concert with greater use of regulatory intervention powers against financial institutions, including requiring enhanced reporting and independent audits or restricting product offerings.

ASIC Corporate Plan 2021 to 2023

As part of the Corporate Plan, ASIC has committed to continuing to work on previously prioritised enforcement matters such as those arising from the Hayne Royal Commission. Other priority enforcement areas include superannuation, poor product design and mis-selling, and using ASIC's powers or provisions that carry new or higher penalties (such as the duties under section 912A (the duty of financial services licensees to provide financial services efficiently, honestly and fairly) and section 912D (breach reporting) of the *Corporations Act*).

FOREIGN FINANCIAL INSTITUTIONS

We think the foreign AFS licensing regime is a sleeping issue through 2021.

ASIC had previously granted AFS licensing exemptions for a large number of foreign financial services providers to provide financial services to wholesale clients in Australia, where a foreign financial services provider was regulated under an equivalent overseas regulatory regime or if their activities are outside Australia and their only connection to Australia was limited to marketing their product to wholesale clients in Australia. This relief came to an end in early 2020 and transitional arrangements commenced for those that elected to and who were previously able to rely on the sufficient equivalence relief.

The sufficient equivalence relief transitional arrangements come to an end in early 2021 and it will be incumbent on those businesses participating in the transition arrangements to ensure they are appropriately licensed at the end of the transition period.

A new regulatory framework for foreign financial services providers who provide financial services to wholesale clients commenced on April 2020. The framework comprises a new foreign AFS Licence and a funds management exemption for eligible FFSPs providing certain limited funds management related services in Australia.

Financial institutions operating under these arrangements and new entrants will need to maintain a strong engagement with the regulatory framework during the coming months.

PAYMENT SYSTEMS REVIEW

At the end of 2020, the Government commenced its review of the payments system sector, as part of its JobMaker Digital Business Plan. The review, which will be led by Treasury, will focus on the regulatory architecture of the Australian payments system to ensure it remains fit-for-purpose and is capable of supporting continued innovation for the benefit of consumers, businesses and the broader economy.

Importantly, the review will consider the findings and evidence provided to other recent reviews that impact on the payments system, of which there are quite a few, including the following which are acknowledged:

- the Senate Select Committee's interim report on Financial Technology and Regulatory Technology
- the Australian Payments Council Review of the Australian Payments Plan
- the Productivity Commission's Inquiry Report into Competition in the Australian Financial System
- the Reserve Bank of Australia and the Australian Competition and Consumer Commission's Conclusions Paper into the New Payments Platform Functionality and Access
- the Review into Open Banking in Australia
- the Inquiry into Future Directions for the Consumer Data Right
- the Council of Financial Regulators' Review of the Regulation of Stored-value Facilities, and
- the evidence provided to Treasury in its discussion paper on Initial Coin Offerings

It is clear that payments regulation is chequered and needs to be responsive to advances in payments technology. The terms of reference acknowledge that the COVID-19 pandemic has seen consumer appetite for using different payment platforms accelerate, including a significant increase in demand for digital payments.

We recommend that businesses with a connection to the new payments platform, distributed ledger technology and data in particular should follow this review as, amongst other things, it will look at the roles of industry self-regulation, regulators and the government, and to consider:

- current regulation of the payments system and if it adequately accommodates innovative technology
- enhanced competition in payments and the enhancement of the roll out of the New Payments Platform
- consumer understanding of alternative payment methods
- global trends in payments and how Australia should respond to ensure it remains internationally competitive

The review will provide a report to the Treasurer by April 2021. It will focus on the overall regulatory architecture and not explicitly consider specific regulatory settings that are currently in place. However, the review will take into account the Government's announced reforms to Stored Value Facilities in making its recommendations.

5 MINUTE SECTOR SYNOPSIS

Insurance sector

- Insurability of Loss constituted by return of premium for impugned insurance products/excessive interest generated by conflicted rates/fees for no service or where "mySuper" option not actioned.
- The new reforms on disclosure will have a significant impact on underwriting.
- Unfair contract terms are already creating large work project streams for insurers.
- Although adding claims handling as a regulated activity should present insurers with little extra initial management burden, the ability of ASIC to make information and document requests, and take licence action, will mean that insurers will need to tightly monitor compliance.
- Continued uncertainty in relation to efficacy of Hayne Royal Commission exclusions and associated Year of Account issues (particularly in a section 54 enabled environment).
- Aggregation of claims remains contentious.
- The ability to rely on insolvency exclusions post *Kaboko*.

Banking sector

- Traditional banks are releasing new product features to retain existing customers and compete with disruptors.
- Customer engagement is a critical issue for banks to retain and attract new customers.
- COVID-19 as a catalyst for digitisation has contributed to digital trends disrupting the banking industry with a shift to mobile and online banking, platforms and Neo bank models to continue to be pursued.
- Disruptive banking technologies are competing with traditional banking and may become targets for acquisition.
- Banks continue to divest financial planning with robo-advisors and AI starting to penetrate money management.
- Continuing interaction between banks and fintech to expand banking as a service via APIs to enhance banking offerings.
- Expanding use of open banking and the forging of new relationships between banks and fintech to facilitate data networking across institutions.
- Australian regulation (and economic stability) a sought after business model for export.
- Regulators will want to see a well-managed consumer engagement and response to COVID-19 events, and digital customer engagement is a critical issue for banks to retain and attract new customers.

Payments sector

- Continuing emergence of new and innovative payment methods and next-generation payment infrastructure as the law and regulators play catch up.
- Payments System Review, a shift toward modernising payment systems infrastructure and corresponding law, governance and regulatory change to support this.
- If you build it, they will come: the strong levels of innovation and new product design to continue to support customer digitisation trends.
- Technology will fuel new methods of payment and associated offerings and will compete with banking products by providing financial services infrastructure on an as-a-service basis. Digitisation of payments continues to expand including retail payments and mobile P2P payments and B2B payments via digital remittance and digital real time payments.
- Increasing trend in use of cashless payments by reducing intermediaries such as eWallet, loyalty apps, and mobile payments.
- Further technological enhancement of open or closed payment platforms to achieve a frictionless buying process for consumers.
- Increasing fraud and cybersecurity risk as a result of proliferating payment models and alternatives.
- Tailored platform structures to drive licensing and regulatory compliance.
- Distributed ledger technology applications to be a focus and rising use of robotic process automation, AI, blockchain and machine learning.

Managed funds sector

- Liquidity and withdrawal arrangements to be a high regulatory priority.
- Operator financial resource licensing obligations and risk management to be a high regulatory priority given the current economic pressure facing wealth managers.
- Technology and opportunity themed funds to be sought after.
- Restructuring to manage excessive debt a focus for trustees and fund managers.
- New platform-based structures to continue to be driven by technological innovation.
- Investment products to target new micro consumer groups.
- Distribution strategies to evolve and be data driven as conflicted remuneration reforms take hold.
- Australian Asia Region Funds Passport fund continues to be available for product launch.
- Distributed ledger technology to continue to test the custody and administration sectors.

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