prospa

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Dear Sir/Madam

DRAFT TREASURY LAWS AMENDMENT (NON-ADI LENDER RULES) BILL 2017

Prospa is pleased to make a submission to inform the Government's consideration of new APRA powers to address financial stability risks to be implemented through the Treasury Laws Amendment (Non-ADI Rules) Bill 2017 and accompanying material (the draft Bill).

Our submission covers both aspects of the Bill:

1. The new "reserve powers" for APRA to make rules concerning the lending activities of non-ADI lenders for the purpose of addressing financial stability risks; and
2. APRA's enhanced powers to collect statistical information from non-ADI lenders for the purposes of monitoring their activities and determining when to use the new "reserve powers".

Introduction

Prospa is a leading online lender to Australian small business. We help Australian small businesses access funds so they can seize opportunities to grow and manage their cash flow. With access to finance, owners can develop, build and ultimately create fulfilling jobs and economic development. We're Australian-owned and operated and our smart technology platform was built specifically to suit the needs of Australian small businesses.

Using a smart proprietary technology platform and a fast, easy online application, we can approve and fund loans of between $5,000 and $250,000 in less than one business day. We focus on the health of a business to determine creditworthiness, rather than the personal credit score of the owner. Prospa loans are often made in circumstances where traditional bank lending would require a long lead time and an asset, such as the family home, being used as security.

We work with thousands of partners ranging from large corporations like Westpac, NRMA Insurance and Reckon, to industry associations and small independent finance brokers and accountants. We're also on the panels of Australia's leading aggregators. In July, the same month we celebrated our fifth birthday, we reached the milestone of $400 million in loans delivered to small businesses throughout Australia.

Our success has been recognised in Australia and globally, with a number of prestigious awards, including:

- Best Medium Business NSW in the 2017 Telstra Business Awards
- Leader of the Year, FINNIES, Fintech Australia (Co-CEOs, Beau Bertoli and Greg Moshal named as joint male winners) and Best Fintech Place to Work, 2017
- AON Hewitt, Employer of Choice 2017
- Lending Innovator of the Year, Fintech Business Awards 2017
- #31, KPMG Fintech100 Global Established Innovators, 2016
- Winner, Deloitte Tech Fast50, 2016

Prospa supports the submission of the Australian Finance Industry Association (AFIA) and the Fintech Australia submission. However, Prospa would also like to make its own specific submissions in respect of the proposed amendments as an online small business lender.

1. **APRA Financial Stability "Reserve" Powers**

Prospa appreciates that the draft Bill intends for APRA's rule-making to be a "reserve power".

However, Prospa, as a leading Australian online small business lender, is concerned with the lack of specificity in relation to this reserved power. As currently drafted, the proposed legislation means the online small business lending market is captured, whether intended or not, as a "lending finance" product.

In its present form, the power is not "reserve", it is explicit for any online small business lender. This means it has implications for any local or overseas investor considering extending funding to an online small business lender.

The proposed changes add unnecessary elements of risk to decision-making for participants in the small business lending market. The changes are potentially onerous to comply with and will impact the ability of new and existing market participants to compete with the traditional lenders.

We believe the online small business lending market needs clarity and certainty around regulation and further, the level of regulation of this segment is sufficient at present. The proposed outcome puts the currently viable online small business lending segment at risk and could stifle new opportunities for innovation, as well as impact a vital new source of finance for small business owners.

Further, the potential risk to financial stability from the activity of online small business lenders as a proportion of the total market does not warrant the unrestricted broad-ranging "reserve power" proposed to be given to APRA through enactment of the Bill in its current form.

Our rationale is as follows:

Regulatory uncertainty has the potential to restrict the growth of competition
Regulation with respect to the fintech sector must be nuanced and staged to ensure innovation is encouraged and incentivised. The Commonwealth's consideration of additional regulation is a result of finance activities in the non-ADI mortgage lender market and is unrelated to the online small business lending segment.

Prospa is of the view that there is no public policy reason to impose additional prudential regulation on small business lending at the current time. As the holder of an Australian Credit Licence, Prospa has a number of regulatory responsibilities through ASIC and regulation is set at the appropriate level at present. Additional regulation will have the effect of unduly restricting new opportunities and diverting funding at a critical point in the growth of the fintech sector.

As a balance sheet lender, Prospa's success has been built on the back of commercial and sustainable lending practices, which have enabled us to continue to attract investment locally and from global markets. For the continued growth of the sector, it is important that established players and new entrants are able to clearly understand regulatory requirements. In the event an APRA rule were to be implemented using the proposed reserve power, this should be limited to relevant and

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necessary market segments to avoid the continued uncertainty and lack of clarity of a market-wide reserve power.

Opportunities for fintech and for small business
Prospa's successes have been possible due to an extraordinary level of innovation, speed and efficiency in a market that was previously slow and staid. New business models are limited only by imagination, economic viability and the ability to monetise. Innovation has been used to achieve a better understanding of our customers and to enhance our communication with them.

In this context, premature increases in regulation of fintech businesses pose a risk of stifling and reducing opportunities for new innovation. Regulatory oversight must therefore be scaled to reflect commercial and growth circumstances of the fintech sector. At the same time, it is important that the finance options that small business lenders are able to provide to small businesses are not unduly limited.

Scope and impact of the proposed measures on different fintech models
Among online small business lenders, there are significant differences in how the proposed measures would affect various lenders depending on business and funding models. As the measures are currently proposed, they will not impact peer-to-peer/marketplace lenders as these lenders do not carry debt on their balance sheet and rather, broker a loan and terms between borrower and lender. In the event a new prudential rule were to be placed on balance sheet lenders, there is the potential for this to negatively impact competitive neutrality between online small business lenders. At the same time, the potential for peer-to-peer/marketplace lenders to affect financial stability would not be regulated.

Clarity and certainty
For start-up and accelerating businesses such as Prospa, it is important that the regulatory environment is clear and certain. New entrants and innovators must be able to understand their obligations. These obligations must be easy to understand and should be met without placing too much financial and resourcing stress on growing, innovative businesses. Regulatory measures should be proportionate to the economic risk they are designed to avoid and not impose unnecessary resourcing requirements in order for them to be satisfied. A balanced and proportionate approach to regulation by the Australian Government will assist the fledgling fintech industry to navigate a fragmented and complex regulatory environment and to compete with established lenders.

Small business lending is not large enough to affect financial stability
While financing for small business provides for a significant amount of economic and employment activity, it is unlikely to have any substantial impact on financial system stability.

Indeed, given the ability of small businesses to generate employment and new economic opportunities, it is important that the overall size of the market for small business lending is allowed to increase without undue and unnecessary regulatory restrictions. Increased regulatory restrictions will stifle and limit small business lending at a time when the Reserve Bank of Australia (RBA) says '... growth in business credit remains modest...'[1] Indeed the RBA notes '... a recovery in non-mining (business) investment has been forecast for some time and, given the subdued signals from some leading indicators, it remains possible that a substantial pick-up is still some way off.'[2]

[1] Reserve Bank of Australia Statement on Monetary Policy, August 2017, http://www.rba.gov.au/publications/smp/2017/aug/pdf/04-domestic-financial-markets.pdf, p 52.
[2] Reserve Bank of Australia Statement on Monetary Policy, August 2017, p 65.

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The lending activity of Prospa, and other online small business lenders is growing, but remains a small proportion of the market, especially when compared with the lending activity of banks and other major non-ADI lenders. To place Prospa's lending in the overall context of the financial system and its potential to impact stability, we have considered the March quarter bank lending to business data, published by the RBA, which is sourced from APRA.

In terms of the overall size of small business lending in Australia, most RBA statistics provide data on the size of loans, rather than the size of the business being financed. Published SME lending statistics are for loans of $2 million or less. Total outstanding bank to business credit in the March 2017 quarter was $939.5 billion. Outstanding loans of under $2 million, were 29% of this at $272.5 billion.[3]

Given Prospa's total FY2017 funding of $216 million, these statistics make clear the very limited impact of online small business lenders even as a proportion of bank to SME finance, and bank to all business finance, let alone when compared to the overall financial system.

We therefore submit online small business lending is insignificant and will remain unable to create risk of financial system instability for the foreseeable future. As such, the potential risk of this segment does not warrant the unrestricted broad-ranging "Reserve power" proposed to be provided to APRA through enactment of the Bill in its current form.

Regulatory oversight without the benefit of being an ADI

Prospa is not an ADI and does not have the financial means to become an ADI. There are substantial benefits that come from being an ADI and recognised as a bank. We believe it is counter-intuitive and anti-competitive to regulate an online business lender like Prospa as if it was an ADI without Prospa having any of the benefits of being an ADI (especially in relation to accessing cheaper capital on wholesale funding markets). In addition to potentially limiting or reducing our access to wholesale capital markets, the cost of funding (which is already greater than 750bps over the BBSY) could dramatically increase as funders question why Prospa is regulated like a bank without being a bank. Ultimately this will make it even more difficult and costly for a non-ADI like Prospa to compete relative to the traditional banking sector and will potentially further reduce small business access to capital.

Recommendation

Prospa proposes the rule-making power should be limited to markets/segments that are likely to cause financial system instability, most notably in the non-bank mortgage lending market. Instability needs to be defined with clearly articulated rationale and metrics. The imposition of the reserve power should only proceed once it has been agreed via a public process such as a Parliamentary Committee and following consultation with affected financial corporations and market stakeholders.

2. FSCODA Data reporting

Consistent with the statements set out above, Prospa is of the view that as an online small business lender, we are not currently of sufficient scale to have a direct or dynamic impact on financial stability. As such the inclusion of data from Prospa and others of our scale is unlikely to have an impact of the ability of the APRA and the Council of Financial Regulators to properly monitor the financial stability implications of the non-ADI lending sector.

[3] rba.gov.au/statistics/tables D8 Bank Lending to Business, Selected Statistics

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Given FSCODA reporting is focused on monitoring financial stability implications, data reporting should be limited to lenders in the relevant segments and of a scale to have a genuine impact on financial stability. According to the Explanatory Memorandum to the proposed amendments, the role of non-ADI lenders in the mortgage and personal finance markets has been identified as a potential risk to financial stability in these markets.

Recommendation

Prospa proposes that qualification under FSCODA should require the satisfaction of two limb test (a) the sum of assets in Australia consisting of debts due and (b) that the finance activity be in a segment relevant to financial stability (eg mortgage and personal finance lending).

In relation to test (a) Prospa proposes the level for data reporting be set at over $100 million per annum, in line with support for the AFIA submission. This would have the benefit of setting a monetary threshold to reflect the risk of the particular market segment under consideration, and ensure the appropriate balance between risk and imposition of a regulatory burden.

In relation to test (b) Prospa proposes that APRA be given a business model discretion on how it applied the reporting requirement, as distinct from a statutory-defined power. This approach would also ensure that the requirement to collect and reporting data only applies to companies in relevant finance segments, while also ensuring the ability of relevant businesses in that segment to absorb the IT, resourcing and other compliance costs of data provision.

Conclusion

Prospa has serious concerns with the current draft Bill. We seek to ensure a competitive and productive market for online small business lenders and SMEs in Australia. We would be pleased to engage further with Treasury on these matters and are happy to discuss any matters related to this submission and online small business lending.

It is the view of Prospa that APRA's new rule-making power should be strictly limited to non-ADI mortgage lenders, which are the primary regulatory driver of the proposed amendments. Small business lending is simply not large enough to impact financial stability. Accordingly, extension to non-ADI small business lenders is unnecessary.

In the event there are circumstances where the Australian Government considers it necessary to implement rules beyond the non-ADI mortgage lending market, then in line with the AFIA submission, Prospa proposes that this power should only be enacted following consultation and should only apply to that specific segment with the potential to give rise to financial instability.

Further, data collection and reporting should be limited to segments, entities and transactions with the potential to impact financial system stability. The threshold for data collection and reporting should be lifted to $100 million per annum and should include all business models such as "P2P (peer-to-peer)" and "marketplace lenders".

Yours sincerely

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