The regulator and marketplace lending

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CHECK AGAINST DELIVERY

Good afternoon, and thank you to Alternative Finance Australasia for the opportunity to present to you today. In my presentation I want to talk briefly about the work ASIC's Innovation Hub is doing to facilitate innovation and help fintech start-ups, including marketplace lending entities.

I will then make some observations on the regulation of marketplace lending and what we are doing in respect of marketplace lending.

ASIC's regulatory role and objectives

Before I describe our Innovation Hub's work let me briefly outline ASIC's regulatory role and objectives.

Our goal is ensuring that the financial services and markets we regulate operate to fund the real economy and drive economic growth. In doing that, we can contribute to improved standards of living for all Australians.

But we can only achieve this if investors, consumers and those needing capital to build their businesses have trust and confidence in our financial services and markets. We therefore believe that industry and regulators have a common interest in seeing innovation that fosters investor and consumer trust and confidence. In the absence of these elements investors will not participate or support innovative businesses, which in the long term means innovative businesses will not survive. We approach the regulation of innovative business, including marketplace lending with this in mind.

ASIC and the fintech sector

Let me now turn to our experience with the fintech sector so far. Innovation is not a new phenomenon, but its scale, breadth and potential, facilitated by technology, certainly is. At the recent World Economic Forum held in Davos, Switzerland, Klauss Schawb, the founder of the Forum, noted that we are on the brink of a technological revolution that could be viewed as the next Industrial Revolution. A key trend in all of this is the development of technology enabled platforms that combine both demand and supply to disrupt existing industry structures.

While these comments were made in respect of the economy generally, ASIC is certainly seeing the impact of innovative business models in financial services. Think about business models like marketplace lending, crowd funding, robo-advice, payments and blockchain technology. These are just a few examples of the potential disruptive developments in financial products, services and markets. Many champions of these new technologies are not incumbents already operating in our markets but rather start-up businesses.

A major difference between the start-up innovators and incumbents, however, is that start-ups often have limited resources—in terms of time, money and access to professional advice.

As new players, innovators may also lack experience in dealing with ASIC. Further, by their nature, innovative business models often need to be analysed carefully to see where they fit in the regulatory framework. These business models can sometimes test regulatory boundaries creating uncertainty about how existing laws should be applied. Fortunately, there is some flexibility in the regulatory obligations that ASIC administers and we have some discretion in our processes. Where we can, we work with the entity to help their business and to cut red tape.

For example, we have powers to grant waivers (‘relief’) from the law or modify the law if it is impractical or inappropriate. This is not something new. ASIC over its time has issued many instruments of relief or waivers, and not just for fintechs and start-ups.

The recognition of the growing importance of the fintech sector and our plans to proactively engage with the sector were just some of the motivators that drove ASIC to establish the Innovation Hub which aims to help innovative, fintech start-ups navigate our regulatory system.

Establishment of the Innovation Hub is also consistent with the current Government’s deregulatory agenda and the focus on promoting innovation. To be clear, ASIC is looking to reduce red tape and improve our engagements with fintech businesses, rather than to change the key principles of what we do.

We are committed to encouraging innovation, particularly where it can lead to better market and consumer outcomes. But it is important to note that the Innovation Hub will not compromise on the fundamental principles of financial services regulation or the licensing process for people in our financial system. To go back to one of my earlier points, we want to try and avoid any measures that might substantially undermine consumer trust and confidence.

ASIC's Innovation Hub

Our Innovation Hub has five elements. The first element is engaging with other fintech initiatives, including physical hubs and co-working spaces that have been established for start-up businesses. For example, Stone and Chalk, and Tyro.

We are making senior ASIC staff available at places like Stone and Chalk from time to time to answer questions.

The second element of ASIC's Innovation Hub is streamlining ASIC's approach to facilitating business for new innovative business models.

Innovative businesses are now able to request informal assistance from ASIC.

If innovators meet some simple eligibility criteria, we will provide guidance about key regulatory issues that they should consider as they set up their business.

The third element is establishing a new area on our website—a one-stop shop for innovative businesses to access information and services targeted at them. We are also progressively adding new content from time to time, including FAQs and other information that we think may be helpful to start-ups that may be regulated by ASIC.

The fourth aspect of our Innovation Hub is the establishment of a senior internal Taskforce. This Taskforce includes Senior Executive Leaders from many teams in ASIC and is chaired by me. We want to take a 'One-ASIC' approach to new business models.

Finally, we have established the Digital Finance Advisory Committee, or DFAC for short. DFAC is made up of industry, consumer and academic representatives and helps guide our work.

To give you an idea of the level of engagement we've had with the fintech sector since establishing our Innovation Hub the following are statistics of the number of fintech businesses we currently have recorded as part of Innovation Hub work.

Statistics: ASIC matters underway (28 January 2016)

ASIC matter	Number
Marketplace lending	25
Robo-advice	25
Payments	9
Credit	8
Crowd sourced equity funding	7
Other	13
Total	**87**

Note: These statistics represent the matters on our registers, including accepted requests for informal assistance, applications for waivers ('relief') and innovation-related matters with other ASIC teams (e.g. Licensing). In addition we have held 89 external meetings with new fintech businesses, industry organisations and other agencies.

Marketplace lending

I'll turn now to marketplace lending. As you may expect given the development of marketplace lending in Australia, ASIC has been engaging with marketplace lenders for some time. Marketplace lending can offer an alternative source of funding to individuals and SMEs than more traditional channels. At the same time, for investors, it could also represent an opportunity to invest in an arrangement that gives more direct exposure to personal and/or SME debt. So far the industry remains small in Australia, with around $50 million in loans to date. However the number of entities looking to enter the industry is growing fast as evidenced by the number of entities ASIC has engaged with through our Innovation Hub.

In our experience there is quite a variation of marketplace lending business models. Broadly, however, we consider marketplace lending to involve retail or wholesale investors investing money which is then lent to borrowers (consumers or businesses) by the marketplace lending operator. Generally, the marketplace lending platform operator or a related party assesses the creditworthiness of borrowers and matches the investors' funds to borrowers that are creditworthy. The interest rates are set in various ways, depending on the platform. They can be set by the borrower and investor or by the platform based on the creditworthiness of the borrower in addition to other criteria. Investors may invest in one or more loans and they may select the particular loan(s) they want to invest in or not invest in.

Regulation of marketplace lending

I'll turn now to the regulation of marketplace lending and ASIC's initiatives that are particular to marketplace lending. As I mentioned earlier, one of ASIC's objectives is to promote investor and financial consumer trust and confidence. We consider that appropriate regulation of marketplace lending helps to promote that trust and confidence. This in turn will help the marketplace lending industry succeed in the long term.

The way we regulate marketplace lending depends on how it is structured. In our experience, despite the variations in the different models used, most marketplace lending businesses are structured in a way that meets the legal definition of a 'managed investment scheme' in the *Corporations Act 2001* (Corporations Act).

But of course we don't think that this is the only way that marketplace lending can be or should be offered. It may be possible to offer marketplace lending by issuing debentures or other securities. Marketplace lending may also involve the operation of a financial market. These are all things that we regulate and different rules apply to each structure.

To assist people considering entering the market, and to help them understand the regulatory requirements for marketplace lending, ASIC will soon publish an information sheet on this topic. The information sheet largely focuses on the regulation of managed investment schemes as this is the dominant legal structure we have seen to date. But much of the guidance in the information sheet will be relevant regardless of the structure used. The information sheet will not only cover the regulatory requirements for marketplace lending, but will also include some suggested good practice that can help investors understand marketplace lending.

Let me now run through some of the key messages as a way of explaining the regulatory requirements for marketplace lending.

First, the operator of any managed investment scheme (the most common legal structure we have seen at this stage) needs to hold an Australian Financial Services (AFS) Licence. If the scheme is offered to retail investors it needs to be registered with ASIC and the licensee needs to have an authorisation to act as, what is called, a 'responsible entity'.

The authorisation to operate a marketplace lending platform is what we refer to as a 'tailored authorisation'. In other words, the authorisation allows for the operation of a particular named scheme that is described in the licence as the marketplace lending scheme. An authorisation to operate a registered managed investment scheme comes with various obligations under the law as it allows the entity to manage retail investors' money. Some of the duties of the responsible entity who operates the scheme are:

- that the responsible entity should act in the best interests of members of the scheme
- that the responsible entity should exercise the degree of care and diligence that a reasonable person would exercise in the responsible entity's position, and
- that members of the same class of investors are treated equally and members of different classes of investors are treated fairly.

Operating a registered managed investment scheme also requires the issue of point of sale disclosure called a Product Disclosure Statement (PDS). This is a critical document that needs to explain how the marketplace lending product works, the key benefits and risks of the product, the fees, how the money is invested and what happens when things go wrong.

If marketplace lending is only offered to wholesale investors then the scheme does not need to be registered with us. However the operator of the scheme still needs to hold an AFS licence. We are aware that some marketplace lending providers may seek to rely on exemptions from holding an AFS licence under the Corporations Act and instead rely on someone who already has a licence.

While as a general principle there is nothing wrong with using someone else's licence to provide financial services, be aware that there are limitations in this approach that are particularly relevant for marketplace lending businesses. In particular, current laws don't allow someone to operate a managed investment scheme and issue interests in the scheme using these exemptions. Generally, to operate a managed investment scheme and issue interests in the scheme, the marketplace lending provider will need its own AFS licence to provide the financial services.

If the marketplace lending platform lends to consumers then the platform operator will also need to hold an Australian credit licence. This requires the holder to comply with requirements in the *National Consumer Credit Protection Act 2009* (National Credit Act) and National Credit Code (which is contained in Schedule 1 to the National Credit Act). These requirements include responsible lending obligations. However, business loans are not regulated under the National Credit Act and National Credit Code.

ASIC relief

ASIC has discretionary power to give waivers ('relief') from the requirements of the Corporations Act and National Credit Act and National Credit Code. In deciding whether to grant these waivers ASIC will look at whether it appears unreasonably burdensome to comply with the relevant requirements under these enactments. We have issued detailed guidance on how to make an application for relief, and information that should be included in an application, in Regulatory Guide 51 *Applications for relief* (RG 51). Some examples of relief granted to marketplace lenders include:

- relief from the legal process that would otherwise need to be followed when certain investors withdraw their money
- relief from the requirement to seek registration of a separate managed investment scheme for each loan entered into through the lending platform, and
- relief to allow a provision fund to be established to compensate investors if particular loans 'go bad'.

Advertising

Advertising of financial products can be very influential on investors. It is important that any advertising for marketplace lending is balanced and is not likely to mislead or deceive. ASIC has guidance on good practice in advertising which is relevant to marketplace lending in Regulatory Guide 234 *Advertising financial products and advice services including credit: Good practice guidance* (RG 234). Some particular things to be careful about in advertising marketplace lending are:

- To the extent that marketplace lending advertising includes a quantitative reference to the creditworthiness of borrowers, such as AAA or BBB etc, there should be a good explanation about what this means. This will help ensure that the reference to ratings of borrowers' creditworthiness does not create a false and misleading impression that they are similar to ratings issued by traditional credit rating agencies for example.
- While marketplace lending offers an alternative to borrowing money from other sources, such as a bank, it is not appropriate for any comparison to be made between marketplace lending products offered to investors and products offered to consumers of banking products, such as saving accounts and term deposits. Words such as 'savings', 'saver' or other terms used in relation to banking products should be avoided in advertising or disclosure for marketplace lending financial products. For investors, comparing marketplace lending products to prudentially regulated products offered by banks is not comparing 'apples with apples'.

Good practice

It is important that investors have clarity about the roles and responsibilities of all those involved in market place lending and the risks of investment. As a matter of good practice, marketplace lending providers may wish to also consider one or more of the following strategies to further assist investors in understanding marketplace lending products and relevant risks:

- refer investors and borrowers to the information on our MoneySmart website to help them understand marketplace lending
- provide investors with an appropriately designed risk warning statement. Testing any risk warning statement can help to make sure it is effective
- offer investors the ability to do an optional on-line test to see if they understand the product before they invest
- provide the following information on their website:
    - information on the policies and procedures for managing the selection of borrowers and ongoing monitoring of loans (without disclosing commercially-sensitive information), and
    - aggregated information about the loan book on topics such as interest rates, loans amounts, term of the loans and whether loans are secured or unsecured.

Marketplace lending depends heavily on the internet and electronic transactions. So we strongly encourage marketplace lending providers to consider ASIC's Report 429 *Cyber resilience: Health check* (REP 429) on managing online fraud and other cyber risks. Cyber attacks are not just a regulatory risk, they are a business risk.

Other ASIC initiatives: Marketplace lending taskforce

Apart from our information sheet, which is now in its final stages of development, I also want to outline some other ASIC work.

We have set up an internal taskforce on marketplace lending that will help monitor industry developments. The group is made up of representatives from across various teams within ASIC to help coordinate our dealings with the sector and make sure the current regulatory regime remains fit for purpose.

The final thing I want to quickly mention is that we are planning to periodically survey platform operators to understand how the sector is developing. This will be a voluntary survey, that we hope all operators will participate in, which will help to keep us better informed of industry growth and any change in risk profile over time.

Final message

As I mentioned before, marketplace lending models differ and the regulation of marketplace lending depends very much on the model. So if you're not sure how your model will be regulated then come and talk to us. If you're new to the industry and think you meet the eligibility criteria for ASIC assistance then please contact our Innovation Hub.

It's an exciting time for this sector and we are always keen to speak to you.

Many thanks for your time today. I would be happy to answer any questions.