SUBMISSION PAPER

DRAFT TREASURY LAWS AMENDMENT

Non-ADI Lender Rules Bill 2017

August 2017

This Submission Paper was prepared by FinTech Australia working with and on behalf of its Members; over 130 FinTech Startups, VCs, Accelerators and Incubators across Australia.

Introduction and Background

FinTech Australia and its members welcome the opportunity to provide feedback to Federal Treasury regarding the draft APRA Non-ADI Lender Rules Bill 2017.

We appreciate the broader context of this bill and its intention to address possible financial stability issues in the Mortgage lending market. However, we would like to ensure that the expansion of APRA's powers into new arenas do not bring about unforeseen and unintended consequences that may hinder or even harm Australia's emerging fintech lending industry.

Australia's fintech lending industry is very well regarded by international peers and regulators, and is providing high quality and cost-efficient services to a number of under-served niches, particularly in Small Business Lending. This in turn is creating both economic and jobs growth, both from the fintech lending industry and from the customers they in turn serve.

It is with this in mind that FinTech Australia provides the following feedback, which is also in line with Prospa's submission to Federal Treasury where the points are elaborated in further detail.

1. Rationale for granting APRA rule-making powers to improve financial stability

Whilst FinTech Australia appreciates the present context of the Mortgage lending market and surrounding over-anxious Media coverage, an examination of historical context surrounding APRA's ability to regulate Australia's lending market does not point to any need for additional rule-making powers to be granted.

The proposed rule-making power has previously existed in "reserve" for over a quarter of a century without ever needing to be used. When elected in 1972, the then Labor Government had regulation of non-bank financial intermediaries (NBFIs) as part of its platform. The Financial Corporations Bill 1973 included a range of NBFI registration and statistics provisions plus (Part IV) intervention/control powers over their interest rates, balance sheet ratios and volume and direction of lending.

When the Financial Corporations Act became law in August 1974, Part IV was not proclaimed and consequently never commenced or took effect; this was due to an industry view, supported by the Reserve Bank and Treasury and accepted by the Government, that market-oriented policies supported by consultation would achieve the desired monetary policy and macroeconomic outcomes.

Subsequent to 1974, none of the significant and broad-reaching Inquiries into the Australian Financial System - not the Campbell, the two Martin, the Wallis or more recently the Murray

Inquiry - have suggested that these sort of “reserve powers” were in any way needed; more so the opposite, with the 1974 Act replaced by the Financial Sector (Collection of Data) Act in 2001, mainly focussed on the provision of statistics by non-ADI entities to inform policy-making.

Furthermore, when the rule-making powers were formerly reserved in 1974, the NBFI sector (adjusted for building societies and credit unions, now ADIs) represented 29% of the regulated (ADI) part of the market. Yet at this time, no need was identified to warrant enactment of the intervention/control powers.

In 2001, the non-ADI proportion of ADIs had dropped to 19%; again, no need for the power was identified as warranted then either. Presently, as per Reserve Bank Data, non-ADIs represent 4% of ADIs total assets. Given the extreme concentration of assets held by ADIs, it is not clear to FinTech Australia and its members why the present proposed expansion of APRA’s rule-making powers over non-ADIs could be exercised in any cost/benefit or ‘best practice regulation-making’ way in support of financial stability. Rather, it may serve to have the reverse impact and indeed concentrate the market even further.

2. Scope of APRA’s new financial stability rule-making powers

FinTech Australia is also concerned with the lack of specificity in relation to the new rule-making powers being proposed for APRA. Given the Explanatory Memorandum identifies the role of non-ADI lenders as a potential risk to financial stability in the mortgage market, it is clear that this new rule-making power has been designed with that specific policy outcome in mind.

However, as currently drafted, the proposed legislation means the fintech lending market, in addition to marketplace lenders, are captured as a “lending finance” product, whether intended or not. In its present form, this power becomes explicit for any fintech small business or consumer lender. This means it has implications for any local or overseas investor considering extending funding to Australian fintech lenders.

The proposed changes add unnecessary elements of risk to decision-making for participants in the fintech lending market. Allowing APRA to create and amend rules in relation to the sector, even if in consultation with ASIC, would create a more complex regulatory environment that may even exacerbate the existing challenges of overlapping jurisdiction between APRA and ASIC for lenders. As such, it may potentially become onerous to keep track of and comply with both APRA rules and ASIC regulation, which will impact the ability of new and existing market participants to compete with traditional lenders.

Further, the potential risk to financial stability from the activity of fintech small business or consumer lenders as a proportion of the total market does not currently warrant the unrestricted broad-ranging rule-making powers proposed to be given to APRA through enactment of the Bill in its current form.

Recommendation
FinTech Australia proposes the rule-making power should be limited to markets and/or sub-segments, e.g. ASIC-regulated lenders, that have reached sufficient market share threshold where they could impact the market and cause financial system instability. For example, the market concentration test applied by ACCC requiring firms to report if a merger would take them to over 20% market concentration, could be applied.

Instability should also be defined with clearly articulated rationale and metrics. The imposition of APRA's proposed rule-making 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.

3. FSCODA Data reporting

Given FSCODA reporting is focused on monitoring financial stability implications, and in line with point (2) above regarding scope, FinTech Australia believes data reporting should be limited to sizable lenders in relevant market sub-segments that are 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. However, the Australia marketplace lending sector has not yet reached a significant enough share - even Morgan Stanley's estimate that the sector may reach $22Bn by 2020 would also result in approximately 6% of consumer lending.

Recommendation
FinTech Australia recommends that qualification under FSCODA should require the satisfaction of a 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), the threshold for data reporting should be set at a much higher level than the $5m currently proposed, to $100m in line with the submission made by both AFIA and Prospa. To ensure the reporting requirement does not place an unnecessarily heavy burden on emerging fintech alternative lenders that are nowhere near posing a threat to stability, reporting should be minimal at this point, beginning with only the aggregated total number of loans originated and loan volumes, and other key statistics that may be of interest at a high level.

More detailed reporting, such as on a per-loan basis, should only be triggered once both the sub-industry becomes systemically meaningful and the lender itself becomes substantial within that sub-industry. This would ensure the appropriate balance between risk mitigation and imposition of a regulatory burden.

In relation to test (b), as previously outlined in section (2) on scope, APRA should apply the reporting requirement based on a sub-sector reaching a market share level that might pose threats to financial system stability, 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

FinTech Australia does have concerns with the current draft Bill, and these concerns are shared by many others outside the fintech lending community. We would be pleased to engage further with Treasury on these matters, either in further meetings with Members or further submissions.

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. In the event that there are circumstances where the Australian Government considers it necessary to implement rules beyond the non-ADI mortgage lending market, this power should only be enlivened following further industry 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 also be raised to $100m, and reporting requirements set in a manner that would ensure a balance between risk and regulatory burden.