8 December, 2017

General Manager, Licensing
Policy & Advice Division
Australian Prudential Regulation Authority

Dear Sir/ Madam

This submission is to be treated as public unless indicated otherwise.

Licensing: a phased approach to authorising new entrants to the banking industry

Prospa welcomes the opportunity to comment on the APRA discussion paper “Licensing: a phased approach to authorising new entrants to the banking industry”.

As the largest fintech currently operating in the Australian market, operating for over five years and having delivered more than $500m in loans to small businesses, Prospa is well placed to advocate for the fintech sector, and in particular for established fintech operators. A fact sheet on prospa is enclosed.

Prospa notes that APRA has the stated objectives of

- Making it easier for potential applicants to understand and navigate the licensing process
- Not materially lessening the entry standards that serve as a protection for the Australian community, and
- Supporting increased competition in the banking sector.

We also note APRA recognises the Restricted ADI will appeal more to start-ups than more mature businesses like Prospa who has balance sheet assets in the vicinity of $200m at the present time.

Prospa exists to help Australian small businesses to access funds which will help them to invest in and grow their enterprises. We believe in sustainably funding those businesses, so they can create fulfilling jobs.

We’re passionate about helping small businesses access the funds they need to grow. We are Australian owned and operated and our smart technology small business loan platform was built specifically to suit the needs of Australian small businesses.

Prospa’s submission is informed by the company’s five years of small business lending experience and is focused on the need to ensure that capital for expansion is made available to small and medium sized Australian businesses looking to invest and grow, creating economic activity, employment and new opportunities.

The balance of this submission will seek to clearly respond to and address the questions set out in the discussion paper. The paper also proposes a graduated capital capital requirement variation to the 20% MLH requirement.

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

Yes. Prospa supports the present inquiry to consider establishment of a phased approach to licensing banking industry applicants.

Propsa notes that starting a bank is one of the most difficult businesses to establish due to extraordinarily high barriers to entry.

Barriers generally fall into two main categories:

- Commercial and financial barriers include: access to capital, attraction of a customer base of sufficient scale, establishment of highly robust operational and compliance systems fit for banking business, and
- Regulatory barriers, including the shareholder limit of 15%, the fit and proper person test, as well as other prudential capital requirements.

Prospa recognises regulatory barriers are focused on the need to protect the deposits of customers and provide consumers with the maximum level of confidence so that they can, for example, receive wages and bank savings safely. Indeed as we move to an increasingly cashless financial system, it becomes increasingly important that these systems work effectively and reliably. Beyond our day-to-day usage of the financial system, there is also the critical need to ensure confidence and stability for larger transactions, including the property and mortgage sector on which so much economic activity relies.

Given these substantial barriers, and given the successful initiative of the UK Prudential Regulation Authority (PRA) to introduce a similar model to that proposed in the discussion paper, Prospa supports consideration of a phased approach and greater flexibility for authorising new entrants to the banking industry.

We believe a phased approach to banking licences coupled with an open data regime will achieve the following:

- Improve choice, through better access to finance, and increased competition between financial service providers. This will drive better financial outcomes and consumer experiences for Australian customers and businesses;
- Improve the efficiency of the Australian economy by reducing manual transfer and analysis of data;
- Expedite the development and testing of new financial innovations in Australia; and
- Ensure the Australian financial services industry remains competitive with businesses, both traditional and new/emerging, from other global jurisdictions.

It should be noted the suitability of a phased approach to banking licence will differ for new entrants that are start-ups; as opposed to established players who already have strong balance sheets like Prospa.

It may be appropriate to consider two separate licensing pathways under this regime because a single set of parameters provides insufficient flexibility.

Recommendation:

Prospa recommends APRA proceed with the establishment of a phased approach to new bank licensing in order to assist start-up applicants in overcoming substantial barriers to entry over a reasonable time period, while maintaining robust prudential regulation.

Balance of APRA's mandate
Q: Do the proposals strike an appropriate balance between financial safety and considerations such as those relating to efficiency, competition, contestability and competitive neutrality?

Yes. In Prospa's view, the proposals balance APRA's primary mandate of ensuring financial stability, with the need to ease the very high barriers to establishing a new bank and therefore providing a pathway to establishing greater competition.

While Prospa recognises that enhancing product and price competition is an important and relevant reason for establishing a phased licensing regime, there are broader reasons for such changes which may become more important over time. A phased approach to entry to the banking sector, provided it is able to sufficiently lower barriers to entry, will see the potential for new entrants to change the way banking and finance is done, by implementing innovative, new models and systems.

Indeed potential innovations to optimise the customer experience, go beyond simple price or product competition, but could challenge and change the way consumers interact with the financial system altogether. These innovations change how customers control, manage and interact in their banking experience. Businesses will compete over the level of customer control and autonomy, portability and engagement with other service providers.

While it is not yet clear what changes might emerge, it is clear that new entrants will spur the adoption of new approaches and new business models. Incumbents in the banking sector are unlikely to bring to market leading edge innovations, as they are likely to be hampered by legacy technical and operational infrastructure. It is important then for new entrants to utilise their comparative agility to truly establish new ways of transacting. The regulatory approach must be able to balance the essential requirements for financial system stability, while enabling innovation from these new players.

For example using two way APIs, it is possible for users to connect multiple programs, and enable information to be sent back and forth between two pieces of software. In the banking context it is possible for a customer to directly interact with their bank and banking information, securely via a third party platform. Prospa aligns with the view of FinTech

Australia that that legislative standards should be technology agnostic and notes and supports the UK Open Banking Implementation Entity's broad design principles for Open Banking. The European Union's PSD2 (Payment Services Directive) has established guidelines for how banks will be required to open their payments services to third parties – Third Party Payment Services Providers.

As noted by FinTech Australia, "The EU model in particular is relevant to Australia, as it applies to all institutions equally, and APIs allow consumers to direct third parties to initiate ("write") decisions as well as to share data ("read") to compare products/services. The desired policy outcome of improving competition and making it easier for consumers to switch to more appropriate service providers is only possible if APIs also enable consumers to direct an institution to act to deliver an outcome, as well as to share data for comparison." (FinTech Australia Submission to Open Banking Inquiry: September 2017)

While financial stability of the Australian banking system is critical, it is also important challenger and new entrants in the banking system are supported to create more robust competition.

A fresh look at competition
At the basis of government's regulatory approach to prudential regulation is the need to support a stable financial system ensuring that consumers can have confidence in the banks and other financial institutions they deal with.

In the case of traditional approaches to banking this has required large capital reserves from conservative institutions focused on limited risk, and therefore consumer segments that are reliable. Risk has been limited by the ability to call on collateral or the underlying asset of the loan or alternatively the secured asset base of the borrower which is large enough to cover the borrowed amount in the event of foreclosure. This has resulted in a financial system which provides sufficient and available capital for the mortgage market. In the case of business lending, the traditional lenders will generally make funds available to larger companies which possess significant assets and balance sheets, but this is largely to the exclusion of smaller business.

The establishment of a greater number of banks will not necessarily lead to a larger number lenders willing to lend to small business. In the event that a two phase process does see the establishment of a number of new banks, these new banks will largely replicate the approach of the traditional lenders with respect to small business lending, ie lend to large companies with a significant asset base, or only make loans where the value of the underlying asset is considered sufficient collateral to cover any outstanding liability, in the event of foreclosure.

Prospa takes a different approach, by using data and insight to assess and reduce risk. Rather than securing its lending to limit risk, Prospa is able to harness business data which drills into the business standing of a prospective borrower.

The conversation around competition should not therefore focus on simply increasing the number of banks, but rather, in the view of Prospa, it should shift to considering an entirely different approach to small business finance.

In the context then of a degree of market failure in relation to a lack of small business lending; the importance of continuing to encourage innovative approaches to lending; and also the very successful and robust tools that online lenders now have available to manage and limit lending risk, Prospa proposes an alternative method to both increase competition, and also create improved consumer outcomes.

Prospa is highly supportive of the creation of an Australian Small Business Fund (ASBF). AN ASBF would be generally based on one of the components of the successful British Business Bank (BBB).

The BBB was established by the UK Government, with £1 billion seed funding, together with co-investment from a number of private institutions. Under the BBB model, lending is assessed by lending platforms in partnership with the bank. Loans are available to businesses with a turnover of up to £25 million.

Through its partnership between Government and business, the BBB has been able to establish trust around small business lending. By operating successfully and profitably it stands as an exemplar of a cooperative partnership overcoming market failure, making funding available to small and medium enterprises. It is also able to create value for the consumer and the wider economy, creating and establishing economic activity which might not have otherwise have been possible.

Prospa encourages APRA and the Federal Government to take a different approach to creating competition by establishing confidence in a different approach to limiting and managing risk.

The BBB has clearly been successful and achieved results through a highly innovative partnership model.

Benefits of an ASBF include:

- Making available a pool of funds for businesses lending
- Creating trust amongst consumers for small business lending
- Establishing a highly effective partnership between lenders, who have developed the capacity to accurately assess borrower risk and make capital available; where large, traditional institutions would not otherwise do so.

A short paper, setting out the basic details of the ASBF is **attached** to this submission.

Recommendation:

Prospa recommends:

- consideration of a broader range of issues in relation to competition between banks and other financial institutions beyond product and price competition, to focus on the

user experience and how the customer interacts with their financial institution. This goes beyond simply increasing the number of banks.
- establishment of an Australian Small Business Fund to overcome current market failure with respect to small business lending.

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

Yes, the eligibility criteria are generally appropriate for new entrants to the banking industry who are starting from scratch.

However, we support the view of Fintech Australia and we also recommend "*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 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. "

Restricted ADI Licence phase
Q: 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?

Prospa notes the extraordinarily high barriers to starting a banking business, as discussed above.

Given the relevance of regulatory barriers to protecting the deposits of customers, it is critical that for the ongoing confidence in the Australian banking system, high prudential regulatory standards must be maintained, enforced and protected.

We believe however that it is possible to maintain these high standards, while at the same time providing a more gradual and phased approach to new entry.

Prospa's view is that in order to provide for genuinely new entrants, the regulatory approach should encourage the acquisition of a full banking licence, over time, albeit with conditions in certain circumstances. However it is also important to provide a system which allows growth and the establishment of a larger and sustainable capital base, in a reasonable time frame.

It is of concern that the proposed two year window has the potential to encourage a 'get there at all costs' approach, which may not encourage desirable conduct. Rather than the requirement of acquisition of a full banking licence within a two year period, it would be preferable for APRA, as part of its consideration of an applicant's business plan, to undertake a process of assessing the proposal against a timeframe which might be reasonable on a case-by-case basis, with the possibility of an upper time limit being set during this process.

In Prospa's view, a reasonable timeframe in many cases could be up to three years, to enable the applicant to fully establish. This position is borne out by the experience of the founders of Prospa who, after 5 years, have established a successful business which has made $500 million in loans to customers.

Prospa is of the view that a three phase start-up would be appropriate. The first phase would require the conditions as set out in APRA's discussion paper providing for a restricted licence.

A second phase would be a scale-up period. During this phase a new bank would be required to demonstrate to APRA how it was making good on its business plan. The proponent would also be able to ramp-up their deposit and lending activity above the $2m limit in order to start building the sufficient volume of customers to recover the costs of entry and expansion within a reasonable time period.

This middle step will provide for a progress point on the way to achieving a full banking licence, thereby providing a strong signal to investors and potential investors, ensuring progress towards tier-1 liquidity funding, as well as active capital.

By the end of its third year, it will be expected that the applicant is able to achieve a full banking licence, with or without conditions.

Prospa recognises the interest that some applicants may have a preference to achieving a full ADI licence within a shorter period, or bypassing the phased approach altogether. A middle step however would provide space to a wider variety of potential entrants, while maintaining a robust position for the regulator. In so doing, this will also provide the opportunity for a wider range of innovative banking proponents and genuine start-ups to become part of the process.

Recommendation:

Prospa recommends consideration of extending the phased licensing period to three years, and establishment of a middle phase, during which the proponent would be in a position to ramp-up their market activity, provided compliance with their business plan.

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

Yes.

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

Prospa believes the $2m aggregate limit on FCS eligible deposits is far too low.

Building up product set and capability within a 2-3 year time frame requires a higher level of activity to enable new banks to move to a full licence and be in a position to start building the sufficient volume of customers to recover the costs of entry and expansion within a reasonable time period.

We support the position of FinTech Australia who have proposed: *"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."

prospa

Milestones

5+	>$500m	150
years in market	loans to small business in Australia	employees

>12,000	7,000
small business customers	intermediaries

Achievements

Telstra Business Awards 2017 NSW Category winner	Financial Review Fast 100 2017	Deloitte Fast 50 Technology 2015 Australia Winner	KPMG Fintech100 2016	Fintech Awards Finnies 17 Winner
Winner, 2017	#2, 2017	Winner, 2015 #6, 2016 #15, 2017	#24, 2017	Leaders of the Year

Partners

SUNCORP

xero

Westpac

graysfinance

ReckonLoans

Customer Satisfaction

77

Net Promoter Score

TRUSTPILOT 9.8/10

"The most loved money brand in Australia"