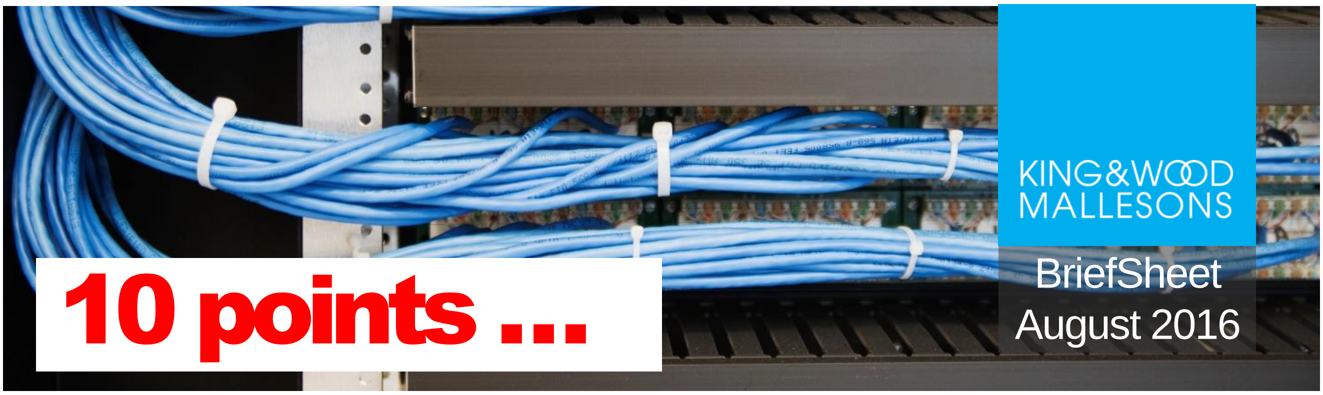

10 points …

KING&WOOD MALLESONS

BriefSheet
August 2016

on marketplace lending

This KWM BriefSheet sets out 10 points on marketplace lending and the way it can transform consumer and SME lending

- **Marketplace lending is ...** The practice of connecting consumers and small–medium enterprises (SMEs) wishing to borrow with individuals or institutions wishing to lend. The “marketplace” is facilitated by a financial services provider via an online platform, which aims to deliver a streamlined financing process with low operating costs. Depending on the business model, the platform provider may originate, underwrite, price or service the loans.

- **… more than P2P lending.** P2P lending is a marketplace lending model where the platform matches the borrower with investors without investing in the loan itself. “Marketplace lending” encompasses P2P as well as online lending utilising other funding models that have since arisen such as direct balance sheet origination, whole loan sales and securitisation.

- **Marketplace lending is quick, integrated …** Platforms typically provide borrowers with faster access to credit than the traditional face-to-face credit application process (often within hours or days, rather than weeks). Products often feature short maturities, repayments via direct debit and integration with accounting software.

- **… and relies on the exploitation of newfound data.** Use of new forms of data and data analytics not traditionally considered by incumbents underpins the economics of marketplace lending, by reducing customer acquisition costs, automating origination, reducing fraud risk and enhancing the credit scoring process. For example, platforms may automate processes such as credit scoring using data analytics and proprietary credit models, allowing them to price risk in ways not available to incumbent financial institutions. This reliance on new forms of data and data analytics poses a new range of risks including those of incorrect analytics or data being exploited contrary to consumer expectations.

- **It’s popular with retail and institutional investors.** Investors have pursued marketplace lending as an alternative source of diversification and yield. Marketplaces often provide transparent loan level data, in contrast (for example) to traditional fixed income investment funds or other debt products. An institutional market in the US and UK for marketplace lending securities is developing: by the end of 2015, the total volume of securitised loans exceeded US$7 billion.

- **Incumbents are both collaborating and competing.** In Australia, institutions have been taking strategic equity stakes in marketplace platforms and developing their own or white-labelled tools. Platforms also tap institutions for warehouse lines of credit or to sell loans directly onto balance sheet, and can complement the incumbents’ businesses through distribution and referral partnerships. This has gone a step further in the UK: the Bank Referral Scheme legislation requires banks to offer SMEs declined for business loans a referral to designated marketplace lending platforms.

- **Regulatory conditions have been favourable to date …** The industry’s growth has been aided by the relatively benign regulatory environment facing non-bank lenders (in particular relative to banks). Platforms are not subject to prudential regulation and have benefited from the banks’ retreat from the SME lending space following tighter regulation and capital requirements in the wake of the GFC.

- **… and clear guidelines prevail …** ASIC has confirmed in Information Sheet 213 that, depending on the type of investment structure adopted, platforms will need to comply with all legal requirements in relation to the structure, including holding an AFSL and issuing applicable disclosure statements. If the platform lends to individuals or strata corporations for domestic, household, personal or residential investment purposes, it must hold an Australian credit licence and comply with the responsible lending obligations applicable to ACL holders.

- **… but the regulators are watching …** The rapid growth of marketplace lending has attracted regulatory scrutiny globally. In early 2016, the largest US platforms suffered major stock market losses when facing questions on the integrity of their business models. As the prevailing economic environment of low rates and low defaults means most marketplace lenders are as yet untested in a downturn, US Treasury recently announced it will work with other US government agencies to develop an appropriate regulatory agenda.

- **… and ready to play.** ASIC’s recent regulatory sandbox proposal may be an opportunity for new platforms to validate their business model on a small scale prior to obtaining an AFSL, but its usefulness will depend on what activities it exempts — watch this space!

We are here to help you

MARK MCFARLANE
Partner, Sydney
T: +61 2 9296 2478
M: +61 409 661 130
mark.mcfarlane@au.kwm.com

IAN EDMONDS-WILSON
Partner, Sydney
T: +61 2 9296 2520
M: +61 439 190 579
ian.edmonds-wilson@au.kwm.com

KATE JACKSON-MAYNES
Partner, Sydney
T +61 2 9296 2358
M +61 438 487 126
kate.jackson-maynes@au.kwm.com

DANIEL BRAGG
Senior Associate, Sydney
T: +61 2 9296 2269
M: +61 407 012 571
daniel.bragg@au.kwm.com