Fintech fills funding shortfall

Flexible regulators can spur innovation

by Greg Medcraft in Sydney

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Small and medium-sized enterprises are critical for economic growth and an important source of jobs and innovation. However, difficulty in accessing capital can be a problem for these businesses and is often cited as a barrier to their successful establishment and growth. Fintech has the potential to bridge this gap between lenders and entrepreneurs.

Fintech lenders are taking novel approaches to credit eligibility and assessment by connecting with software and accounting applications, and by auctioning business loans to lenders. Fintech lenders may significantly reduce the time and effort that SMEs expend to obtain finance.

In some cases, these lenders can provide an avenue to finance that SMEs could not otherwise access. One such lender is Tala Mobile, which offers micro-loans in Kenya, Tanzania and the Philippines. To evaluate creditworthiness, Tala operates a smartphone app that gives it access to a range of data, from basic biographical facts to behavioural information. It works on the premise that a person's habits are more predictive of their likelihood to repay debts than traditional credit scoring.

In Australia, there is a strong focus on encouraging the development of a varied and sustainable fintech industry. However, the use of artificial intelligence or algorithms in a business model does not mean businesses are immune to regulatory scrutiny.

In responding to the pace of innovation in this area, the Australian Securities and Investments Commission's approach to regulating fintech has four key elements.

The first is to be responsive to the speed and nature of change. Asic established its Innovation Hub in 2015 to assist fintech start-ups navigate the regulatory framework. The hub is a response to challenges faced by start-ups and recognises that pioneering services often do not fit within existing rules.

For new non-bank lenders, Asic has adapted existing regulatory frameworks to accommodate peerto-peer and marketplace lending. Many of the peer-to-peer lenders in Australia operate as managed investment schemes. This means that the provider needs to hold an Australian financial services licence. Australia's 'regulatory sandbox' framework also permits start-ups to test their products without a licence in some circumstances.

The second element is resisting the temptation to act too quickly before Asic properly understands developments. When poor lending behaviour is noticed, Asic will use the tools available to it. If new developments raise concerns, it can make recommendations to the government for legal reforms. The importance of co-operation with other regulators cannot be overestimated in facilitating innovation and understanding new trends, particularly in emerging markets.

The third principle is ensuring that regulatory responses are 'technology neutral'. Online or app-based non-bank lenders are subject to the same regulatory environment as offline non-bank lenders. However, while the obligations are the same, the risks posed and the treatment of those risks can be different. Cybersecurity, privacy and data protection concerns mean that there are heightened risks heightened risks for online lenders, borrowers and investors.

The fourth principle is ensuring Asic has the necessary skills and expertise to be an effective regulator. Engaging with fintech entrepreneurs allows Asic to monitor and understand technological and market developments. Social media analytics can be put to use to monitor hotspots, and, as an example, Asic is trialling machine-learning software to identify misleading marketing.

Asic wants to encourage fintech businesses to provide new financing alternatives, but without compromising its core regulatory objectives. The aim ultimately is to promote investor and consumer trust and confidence, ensure markets operate transparently, and mitigate systemic risks.

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