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SUBMISSION PAPER:

# Options Paper Financial Institutions Conduct

*This Submission Paper was prepared by Prospa NZ Limited (FSP663891). [www.prospa.co.nz](http://www.prospa.co.nz)*

Prospa NZ Limited ("Prospa") welcomes the opportunity to provide feedback on FMA's Option Paper.

Not all options outlined within this Options Paper relate to Prospa's business model or product offering so the following responses have been drafted accordingly.

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## 1. A little about us – “Prospa”

Prospa is an Online Small Business Lender offering Small Business Loans between \$5,000 to \$150,000, with all customers of Prospa being small businesses. All funding decisions are achieved by assessing well over 450 data points, including turnover, profit & loss, business tenure, size and industry sector. All applications are processed using Prospa’s bespoke secure online and phone application process, querying data sets that determine overall approval limits and risk-based pricing.

Off the back of solid growth, encouraging portfolio performance and positive economic stimulus in Australia, multi-award winning Prospa launched in New Zealand in August 2018.

Prospa has developed a sophisticated risk-based scoring methodology developed over many years of lending to small businesses which verifies specifics of the small business applicant by utilising data from resources such as government websites, credit bureaus and third-party service providers such as bankstatements.com.

The use of online small business lenders such as Prospa by small businesses is increasing, due to the ability to provide online application processes, timely credit decisions and funding, unsecured finance, repayment flexibility and an excellent customer experience.

As awareness heightens in New Zealand, we expect small business owners will increasingly consider online small business lenders, such as Prospa, as an alternative to traditional lenders.

In Australia, increased awareness has been driven by several factors including:

- Increased number of industry participants;
- Increased marketing investment by industry participants;
- Increased media discussion of online lenders; and
- The Australian Government reference to online lenders as a viable alternative source of finance for small business owners (at both the State and Federal level).

Prospa is currently Australia’s #1 Online Small Business Lender<sup>1</sup>, operating out of its Sydney headquarters. Prospa has supported small businesses with business funding for over 7 years and employs over 230 company representatives in Australia and already has 4 full time employees working out of our Auckland office.

A recent independent study conducted by RFi Group and the Centre for International Economics on behalf of Prospa, revealed the positive economic impact of Prospa’s lending to small business in Australia. See full report [here](#).

Prospa is confident the same broader economic benefits will be realised in New Zealand as Prospa scales up its business footprint by executing our diversification strategy throughout New Zealand.

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<sup>1</sup> Market position for online balance sheet lenders to Australian small businesses, based on Prospa’s volume as a percentage of total market volume in 2017 as reported in KPMG “The 3rd Asia Pacific Region Alternative Finance Industry Report”, November 2018; USDAUD FX rate of 0.767.

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## 2. Initial comments

As Prospa is relatively new to the New Zealand market, we are keen to be an active participant when the opportunity arises to contribute towards government, industry and regulatory consultation programs,

It would appear a substantial amount of content within this Options Paper is also simultaneously being addressed in other consultation programs underway, for example, the review of New Zealand's Credit Contracts and Consumer Finance Act 2003 ("the CCCFA").

Having dual consultation programs running concurrently, where obvious overlap is occurring across two different legal regimes, does present difficulties and at times confusion which could ultimately lead to misguided feedback being received, and potential unintended consequences for both industry and consumers more broadly.

It's Prospa's understanding that legislation already exists such as the Financial Markets Conduct Act 2013 ("FMCA") which outlines clearly what is expected from financial institutions operating in New Zealand to achieve reputable compliance standards whilst delivering positive outcomes for consumers.

Prospa did find some aspects of this Options Paper confusing as it wasn't clear exactly who the intended beneficiary of the proposed amendments would be. For example, in paragraph 11 of the Options Paper, it states:

*"When we refer to financial institutions in this paper, we are primarily referring to banks and insurers. However, in section 7, there is a question regarding whether the regime proposed in this paper should apply more broadly to other types of financial institution."*

Prospa was unclear exactly where the Options Paper was heading in terms of which products and institutions the paper was aimed at.

Prospa fully supports conduct obligations and actively promotes best practice in conduct which is demonstrated by the leading role Prospa played in establishing the Online Small Business Lending Code of Practice facilitated by the Australian Finance Industry Association ("AFIA") in Australia. Prospa is delighted to successfully established membership with the Financial Services Foundation ("FSF") in New Zealand to continue our active contribution to the finance industry more broadly.

Caution needs to be exercised when establishing policy and regulatory standards too broadly to ensure, only those industry participants where certain conduct provisions are relevant, are caught by the regime. If the regime is too broad, it can be stifling for smaller or new industry participants thus limiting competition and customer choice. Cost of compliance is built into product offerings so in the end, customers end up paying which can have more broader economic impact, especially for small businesses.

This point is extremely important to acknowledge when looking at Responsible Lending and Suitability assessments for Small Business finance as it's not the individual being assessed for funding, it's the small business itself. Annual turnover, profit and loss statements, industry and product, tenure in business etc. are some of the specific aspects Prospa considers when assessing a Small Business application.

Applying a broad "consumer" style responsible lending standard across industry just isn't feasible nor relevant for this form of lending. Therefore, Prospa is keen to leverage its learnings from Australia to help strike the right balance between "risk vs. reward" and "compliance vs. access" when it comes to small business lending in New Zealand.

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## 3. Question 1

**Which overarching duties should and should not be included in the regime? Are there other duties that should be considered? Do you agree with the pros and cons of each duty? Do you have any estimates of the size of the costs and benefits of these options? Are there other impacts that are not identified?**

Any risk of regulatory overlap and competing tensions between regulation already in place needs to be avoided. When one regime undermines another, this only causes confusion and inconsistency benefiting nobody. This can also lead to unfair outcomes when disputes are heard from any of the various external and independent approved External Dispute Resolution ("EDRs") schemes. Prospa feels as though existing laws adequately cater for overall conduct expectations of finance providers and the FMA has sufficient powers to enforce the laws that govern New Zealand's banking and finance market as and when the need arises.

The obligation to meet duties already exists outside of this proposed regime. Finance institutions are expected to ensure complaint handling is fair, timely and transparent. Its Prospa's understanding that all financial institutions operating in New Zealand are required under the Financial Services (Registration & Disputes Resolution) Act 2008 ("FSPRA") to belong to an EDR. Whilst the service offered by these schemes is free to customers, the handling of complaints by these external schemes is not free to the financial institution.

Prospa reiterates, it's in the best interest of each institution to resolve their complaints fairly, quickly and transparently as soon as is practicable but with the confidence in knowing that should the complaint reach an EDR provider, the EDR will apply the same interpretation of the law to achieve a fair outcome for all parties. Unfair or "customer biased" outcomes can be extremely costly as they can be used against finance providers to extreme detriment; especially given the digital era we live in where every consumer is a journalist.

The overarching duties and corresponding options outlined within this paper appear too broad, as it introduces the real possibility of wide-ranging interpretations. Existing legislation already caters for specific duties to operate using sound business management, provide products designed to be fit-for-purpose for the intended audience, ensure customers get value for money from the products they acquire whilst enabling the provider to remain a sustainable and profitable business. With that in mind, Prospa encourages existing laws be enforced and not introduce new versions of the same duties.

## 4. Question 2

**Do you think the overarching duty for managing conflicts of interest should be general (as it is currently worded) or focus on conflicts of interest that arise through remuneration? What are some examples of conflicts of interest that arise outside of conflicted remuneration and incentives?**

Prospa supports keeping any duty to manage conflicts of interest general rather than specifically focusing on conflicts of interest that might arise through remuneration.

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## 5. Question 3

**Is a code of practice required to provide greater certainty about what each overarching duty means in practice?**

Prospa supports and is an advocate for relevant and effective self-regulation as previously mentioned however “effective” can only be achieved if there is a common appreciation for what each code represents and there is a consistent application across industry. The FMA need to adequately endorse and recognise codes for them to be of any use.

Prospa would encourage that all existing codes be exhausted first before the introduction of any new or additional codes of practise are considered. The less, the better.

Its Prospa’s understanding that there are already several codes in place for various parts of the sector so creating any further codes will only create confusion and will not be helpful in ensuring all institutions and EDR schemes, not to mention consumers, are clear as to what their conduct duties are.

Unnecessary overlap of codes already in existence, will only have the reverse effect specific codes are set out to achieve. Prospa would be happy to provide the benefit of our experience of leading the development of a product specific code for small business lenders.

## 6. Question 4

**Which options for improving product design do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

Broadly speaking, Prospa advocates for responsible access to fit-for-purpose products to all consumers and small businesses. Choice and competition must be allowed to flourish to enable a healthy and productive economy. Product innovation and adaption needs to be allowed to occur with an appropriate level of regulatory involvement.

Prospa is in the business of extending funding options to its small business customers fairly, prudently and with adequate levels of skill and good will. We have developed and rely on our own Prudent Lending Framework (“Framework”) to determine the creditworthiness of small businesses requesting funding from us after target markets have been identified and our product offering has been designed to meet the needs of that market.

A key concept of lending prudently is that lenders must not enter into a credit contract with a consumer or small business, suggest a credit contract, or assist a consumer to apply for a credit contract that is unsuitable for them.

Lenders and their respective funding partners require a sustainable level of comfort and support when enforcing their contracts and should be able to do so without unwarranted fear or threat of regulator or EDR intervention (assuming of course all contracts are fit and proper, meet Unfair Contract Term

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standards and an adequate credit assessment was undertaken). That “moment in time” credit decision must not be ignored or used against the lender later down the track.

In addition to standard financial hardship policy options, Prospa believes all lenders should build into their customer management programs an element of “fairness” with options costed for and made available to customers who do experience unforeseen changes with their financial circumstances during the term of their loan contract and be helped without fear or threat of significant penalty or detriment. Often, if genuine flexibility is offered early, instances of financial hardship can be avoided.

Prospa is of the view that adequate enforcement powers exist already within current laws in New Zealand. The Fair-Trading Act 1986 (“FTA”) prohibits misleading or deceptive conduct, making unsubstantiated or false representations and unfair practices. The Consumer Guarantees Act 1993 (“CGA”) also requires that goods and services are safe and fit-for-purpose and of an acceptable quality as well as that services are carried out with reasonable care and skill.

The CCCFA also imposes quite specific obligations on the providers of credit-related insurance products to ensure that their products are suitable for the individual customer, sold responsibly and at a reasonable price.

In addition, Part 2 of the FMCA is very prescriptive as to the requirements regarding disclosure for financial products. With all this existing legislation already in place, Prospa advocates sufficient consumer protection against poor product design already exists and any further prescription for financial institutions is unnecessary.

## 7. Question 5

**If a design and distribution requirement like option 3 were chosen, are there particular products for which this is more necessary than others? If so, please explain what and why?**

Designing products that are not fit-for-purpose or meet the needs of a chosen target market or cannot be competitive with existing providers, simply won't survive.

Legislation in New Zealand already provides adequate consumer protection and consequences should a product be found not to be fit-for-purpose so again, Prospa is of the view enforcing these existing laws is what's needed, not introducing additional burdensome obligations.

## 8. Question 6

**Which options to improve product distribution do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified – such as unintended consequences or impacts on particular business models? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

New Zealand's financial services sector appears diverse and is made up of many sectors and organisations of varying scale and complexity. Imposing a *one size fits all* regime across product design,

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distribution channels, financial models, remuneration and incentive programs, simply won't effectively or fairly work.

Remuneration incentives exist in every industry, not just financial services as they are an essential tool to reward desired performance. Their existence does not mean they are not good for customers.

Of all the options provided on this subject, Options 1 and 5 are the most preferred because they are the least prescriptive and they allow business models already in place to continue. By acknowledging good performance via financial incentives for employees and agents, leads to better outcomes for customers. Prospa relies heavily on brokers to identify and introduce eligible customers to its products. These brokers are subject to strict accreditation and due diligence assessments which Prospa diligently undertakes with ongoing monitoring programs in place to guarantee optimal outcomes are being achieved.

## 9. Question 7

**To assist us in comparing the pros and cons of various options, please provide information about remuneration and commission structures currently in use (i.e. what are common structures, average amounts of remuneration/commissions, qualifying criteria etc?).**

As mentioned above, Prospa has a network of accredited brokers who introduce our products to eligible small business owners. Prospa also has a team of sales agents, employed by Prospa, who provide customer and broker support. In addition, Prospa has a team of employees located in offshore locations (such as Australia, Philippines) that provide customer service support. As such, a *one size fits all* remuneration model simple wouldn't work.

Prospa would encourage taking more of a principle- based approach, focussed on incentives and remuneration models that drive positive outcomes for customers whilst enabling organisations to offer their products in the way that is appropriate to them and remain competitive and relevant in New Zealand's open market.

## 10. Question 8

**What is your feedback on imposing a duty to ensure claims handling is fair, timely and transparent? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of this option?**

Not applicable to Prospa.



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## 11. Question 9

**If this option were to be adopted, should an attempt be made to clarify what fair, timely and transparent mean? Why? Why not? What are the benefits and costs of doing so?**

Not applicable to Prospa.

## 12. Question 10

**What is your feedback on requiring the settlement of claims within a set time? Are there other impacts that are not identified? How do you think that exceptions should be designed? Should there be different time requirements for different types of insurance? Do you have any estimates of the size of the costs and benefits of this option?**

Not applicable to Prospa.

## 13. Question 11

**Do you agree with this option to empower and resource the FMA to monitor and enforce compliance? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

Lenders in New Zealand are regulated by the Commerce Commission which is charged with enforcing the CCCFA. Prospa believes by introducing another regulator by empowering the FMA to monitor and enforce conduct compliance would only create unnecessary confusion and potential regulatory overlap.

## 14. Question 12

**What is your feedback on the option to require banks and insurers to obtain a conduct licence? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

Prospa reiterates its response to question 11. Introducing a licencing regime only creates a significant barrier to entry for new product providers that in turn stifles competition, not to mention additional costs lenders would need to absorb which ultimately are passed down to consumers.

## 15. Question 13

**What is your feedback on this broad range of regulatory tools? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options**

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**that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

Prospa is not certain at whom the Options Paper is aimed and who is the regulator. Important aspects require clarification before consideration is given to providing additional regulatory tools.

It's Prospa's understanding that the administrative tools suggested under paragraph 194 of the Options Paper already exist for the regulators of the wider financial services sector. Not until regulators can justify their existing tools and powers are inadequate should any additional tools or powers be considered.

## 16. Question 14

**Do you think that the maximum pecuniary penalties available for breaches of any conduct duties should be the same as the existing FMC Act penalties? Is there a case for making the penalties higher?**

The review of the CCCFA, which is currently underway, is proposing stronger penalties for non-compliance with the Lender Responsibility Principles. Prospa's view would be for the penalty regime under the CCCFA apply to lenders for contraventions against any other statute that might apply to them. We would recommend a tiered based approach based on the scale and size of the lender and the potential risk to financial stability.

## 17. Question 15

**What is your feedback on the options of executive accountability? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the costs and benefits of the options?**

As a smaller financier in New Zealand, attracting and retaining appropriately experienced people to become a director or senior manager if they are to be made personally accountable for any breach of the conduct regime without the ability to insure or indemnify themselves against this risk will be extremely difficult. Whilst Prospa can see value with the "Pro" as set out on page 54 of the Options Paper, the three "Cons" expressed alongside this, outweigh any benefit.

Again, it's Prospa's understanding that the proposed amendments to the CCCFA will introduce liability for directors and senior managers of creditors, including a regime whereby the Commerce Commission will certify all such people working in the businesses they regulate. Prospa is of the view that sufficient governance is in place to ensure that directors and senior managers meet the requirement for executives, to act honestly, work constructively with the regulator and to take reasonable steps to ensure that the business complies with its conduct obligations.

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## 18. Question 16

**What is your feedback on the whistleblowing option? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

Its Prospa's understanding that mechanisms already exist for whistle-blowers to report conduct and culture issues to the regulator and to external disputes resolution services as appropriate. Its unclear what would be achieved in setting up other external complaints body as will only serve to complicate the issue of to whom to report. Prospa's own Whistle-Blower Policy encourages whistle-blowing should any issue arise that warrants reporting. Introducing yet another complaints body not only will create confusion but will introduce another cost burden which will ultimately be passed on to the consumer.

## 19. Question 17

**What is your feedback on the option of regular reporting on the industry? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

Reporting as a general concept is beneficial. However, it requires clear guidelines as to what is being reported and who the reporting is targeting and should be based on industry sector with the potential to scale based on the size of the loan book.

Any statistical information gathered would have to be considered in the context of what part of the industry is being reported on, the size of the organisations within the sector, their number of customers and transactions relative to other organisations within the sector. Relativity will be vital to ensure reputational consequences are managed fairly.

## 20. Question 18

**What is your feedback on the role of industry bodies? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?**

Prospa sees a great deal of value having an industry body representing responsible banking, finance and insurance companies. Prospa is a proud member of the FSF as they represent organisations that take their compliance obligations seriously and supports their strict Code of Conduct.

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## 21. Question 19

**What is your feedback on the options regarding who the conduct regime should apply to? In particular: Do you agree with the pros and cons of the options? Are there other impacts that are not identified e.g. do the proposed overarching duties conflict with existing regulation that applies to other financial institutions? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of these options? Which options do you prefer and why?**

It's not clear throughout the Paper who the options apply to, banks, insurers and/or other lenders. It's unlikely the introduction of a conduct regime would only be applicable to banks and insurers as the regulators in New Zealand have a mandate to regulate the entire financial services industry. On this basis, the need for absolute clarity is essential before any real impact assessment can be made to determine any impact, positive or negative.

For example, in paragraph 212 starts by referencing "financial institutions" as providing services that are critical for consumers and serving a large and varied customer base. It's unclear to Prospa whether this extends to Small Business Lenders such as Prospa who exclusively lends to Small Businesses, not consumers.

Another example, Option 1 is targeted at retail customers of banks and insurers. "Retail customers" would suggest "consumers" as opposed to commercial or small business customers so again, clarity and consistency of terms is required.

## 22. Conclusion

Prospa supports the regulation of a practical, fair, reliable and stable underwriting framework across New Zealand, no matter the customer type, product or lender.

Prospa encourages the right balance of regulation, risk and reward which is carefully articulated and well enforced. Core measures of success Prospa hopes will occur once all submissions have been received and reviewed are:

- **Consumers** and **SMEs** are aware of and understand the various credit products and services available to them and how New Zealand law and regulation applies to them specifically by relying on concise, easy to understand, and consistent materials circulating the public arena; and
- **Lenders** can lend in a manner that is acceptable across all stakeholder groups including: consumers, SMEs, regulators, external dispute resolution schemes, industry bodies and advocates without fear of reprimand when operating in accordance with regulatory guides and acting in the true spirit and intent behind all consumer and SME protection laws within New Zealand.

It's evident that a *one size fits all* approach to regulation does not work across the vast number of differing consumer credit providers and SME lenders and nor should it so competition, consumer choice and innovation is encouraged.

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Prospa reiterates the importance of legislation and regulation acknowledge small business lending is different to consumer lending. Small businesses take loans to support business objectives and to enhance the business' capacity to increase output and create more jobs. The funds they borrow are not consumed but used to generate increased output which must be taken into account when assessing future legislation in New Zealand.

If you would like more information regarding our submission, please contact:

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