

# Shaping the future of our markets

13 November 2013

## Consultation: Licensing peer-to-peer lending

### Draft minimum standards and licence conditions for peer-to-peer lending service providers (P2P)

The Financial Markets Conduct Act 2013 (the Act) introduces licensing for providers offering certain types of financial services.

In future, you will be able to apply for a licence to provide a P2P lending service. Licensees will need to meet, and maintain, minimum standards across key areas of their business.

This paper summarises the proposed minimum standards for a P2P lending service licensee. We invite you to review these and share your feedback with us. This is our chance to work together to shape the new future for our industry.

**Submissions close on 12 December 2013.** The form at the back provides more details.

### Quick guide

- |  |             |
|--|-------------|
| <b>1. Overview</b><br>What are peer-to-peer lending services   Minimum standards   FYI   | <b>P 2</b>  |
| <b>2. Fit and proper</b>   | <b>P 3</b>  |
| <b>3. Capability</b>   | <b>P 4</b>  |
| <b>4. Operational infrastructure</b><br>New clients   Assessing borrowers & providing information   Conflict of interest<br>Loan Funds   Debt collection   Material issues & complaints   Resources<br>Staff & supervision   Outsourcing   Records   IT Systems   Termination of service | <b>P 5</b>  |
| <b>5. Financial resources</b><br>Financial resources   Professional indemnity insurance  | <b>P 12</b> |
| <b>6. Governance</b><br>Governance   Culture   Compliance  | <b>P 14</b> |
| <b>7. Licence conditions</b>   | <b>P 17</b> |
| <b>8. Contact details</b>  | <b>P 18</b> |
| <b>9. Consultation form and details</b>  | <b>P 19</b> |

### A. What are peer-to-peer lending services?

In general terms a P2P lending service is one where you act as an intermediary between borrowers and lenders. They must not be otherwise connected to each other, or you, and the loan must usually be for personal, charitable or small business purposes. Peer to peer lending services will be defined in the regulations.

#### Will you need a licence?

It is not mandatory but, if you have a licence, borrowers may issue debt securities through your service without having to supply a product disclosure statement (PDS). See clause 6 of schedule 1 of the Act for more about the exemption, and Part 3 of the Act for PDS requirements.

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### B. Minimum standards – five key areas

To become a P2P lending service licensee your business must meet a range of minimum standards. We propose that providers will need to meet minimum standards in five key areas:

- Fit and proper – ‘fit and proper’ directors, senior managers and other relevant parties
- Capability – the skill and experience of your directors, senior team and staff
- Operational infrastructure – the proper functioning of your P2P business, including your client services and business operations
- Financial resources – financial resources and professional indemnity insurance
- Governance – governance and compliance culture.

You must meet the minimum standards at the time of licensing and on an on-going basis. These proposed standards do not cover all your obligations under the Act or regulations.

## C. For your information

### **Related bodies**

You may apply for a licence that covers any related companies who will provide part or all of the licensed service with you. Where we refer to 'related bodies' it means any related body corporate we include on your licence under Section 400 of the Act.

If you have related bodies under your licence, they must comply with all licence obligations, and you need to provide oversight to ensure your group as a whole meets the minimum standards. Where you use a related body to provide part of your P2P lending service it is usually more appropriate to include them in your licence application than to 'outsource' the activity to them.

### **Systems, processes and procedures**

Throughout this paper we talk about the need for systems, processes and procedures, or arrangements. We cannot be more specific because regulations and standards are still being finalised and, importantly, because what will be required will depend to some degree on the nature of your business. We will take the size, complexity and nature of your business into account when we assess your application.

### **Please note**

This paper is intended to give you a high level overview of the proposed minimum standards and licence conditions for market service licensees that will come into effect under the Act, so that you have the chance to comment. Regulations are still being developed and there may be changes. A licence application guide will be published after regulations are finalised.

## Part 2. Fit and proper

### Fit and proper

Your directors and senior managers must be fit and proper persons to hold their respective positions.

#### Minimum standards

1. Your directors and senior managers (current or proposed) must be fit and proper persons to hold their position. This requirement broadly covers the tests of:
  - **Good character** covering integrity, probity, trustworthiness, character and reputation (see note 1)
  - **Capability** – competence, skills and experience – the next section on capability provides more details.
2. You must have recruitment and human resources processes to ensure that directors and senior managers undergo a character assessment – and that their competence, skills and experience are assessed before they assume their roles.
3. If you have related bodies under your licence, each entity's executive directors and senior managers who are responsible for the licensed service must meet these minimum standards.

**Note 1:** We will assess **good character** based on various factors including (but not limited to) past non-compliance; convictions or involvement in dishonesty, deceit, theft or fraud; failure to manage business or personal financial affairs; dismissal from a position of trust; and adverse information from other public bodies including other regulators and Inland Revenue.

We must also consider whether your owners or other relevant parties have had any convictions or successful disciplinary actions taken against them. The regulations will provide more details about what we must take into account.

### Capability

You need to show you have the right mix of people, with the right skills and experience, in the right roles, to run your P2P lending service properly and effectively.

#### Minimum standards

1. Your senior management team (collectively) must have an appropriate breadth and depth of relevant financial industry know-how (relevant to P2P lending services), whether in New Zealand or elsewhere.
2. Roles are documented and include clear responsibility and accountability for:
  - Effective operation of the key activities of a P2P lending service (see note 1)
  - Strategic development and direction of your business
  - Risk management
  - Financial management
  - Compliance with product-specific laws and regulatory requirements
  - Compliance assurance/Internal audit to ensure controls and procedures are effective
  - Customer complaints.
3. Your recruitment and human resources processes ensure that directors and senior management's skills and experience enable them to perform their roles. You will have considered:
  - Present or past roles and length of time in those roles
  - Relevant qualifications (formal qualifications will be particularly relevant when a person is to fill a key financial control role)
  - If their current role is not relevant – when the last relevant role was held, and for how long.
4. Your business has access to any necessary professional advice (for example legal or tax advice) either through internal appointments or external consultants.

**Note 1:** For example key activities may include client on-boarding, client liaison/relationship management, IT infrastructure and security, data management, legal documentation, debt collection, and oversight of outsourced activities.

## Part 4. Operational infrastructure

**New clients | Assessing borrowers & providing information | Conflict of interest | Loan Funds  
Debt collection | Custody | Material issues & complaints | Resources | Staff & supervision |  
Outsourcing Records | IT Systems | Terminating service**

### A. New clients

Your procedures for bringing clients on board must ensure they get sufficient information to make informed decisions about the financial services offered – and that the services are not inappropriately marketed.

#### Minimum standards

1. You must maintain adequate and effective systems to bring clients on board with processes and controls to ensure the requirements of the Act are met, including the

- Fair Dealing obligations in Part 2 of the Act
- Disclosure obligations in Section 423 of the Act
- Requirement for a written client agreement in Section 430 of the Act.

You may also have other legal requirements to meet (for example under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009, and the Privacy Act 1993).

2. You ensure your clients (both borrowers and lenders) have enough information to make informed decisions about the licensed service.
3. You provide disclosure statements and client agreements that can be easily understood by the intended audience.
4. You have effective procedures to identify failures in any system or process for bringing a client on board.
5. Staff are aware of their professional obligations and are adequately trained in the systems and processes for bringing clients on board.

## B. Assessing borrowers and providing information

You must have a clear process for conducting background checks on borrowers and providing transparent information to lenders.

### Minimum standards

1. You have adequate and effective processes and controls for doing background checks on borrowers and assessing the risk of non-repayment, for example with a credit check.
  2. You publish and maintain clear eligibility criteria for borrowers on your platform.
  3. You maintain clear and transparent information about what due diligence you have and have not carried out on borrowers, so lenders can make reasonable judgments about the risks of lending.
  4. The provision of information about borrowers is fair and transparent, so all potential lenders have access to the same information.
  5. Your mechanisms for collecting and delivering information don't discriminate between different lenders or borrowers.
  6. You provide clear and transparent information about the lending process, including if the lender has any right to exit or assign a loan before it matures.
  7. You publish information about the rates of default by borrowers using your facility. This information is published in a fair, clear and transparent manner.
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## C. Conflict of interest

You identify and deal with conflicts of interest in a fair, open and transparent way.

### Minimum standards

You must be fair and transparent and before lenders agree to make a loan you must disclose to them:

1. If you, or anyone commercially associated with you, has a direct or indirect interest in any borrower seeking a loan through your facility – *if your licence conditions allow the associated parties to use the service.*

This includes disclosing the nature and extent of the interest (or intended interest) and any fees the borrower pays you above the standard disclosed amount.

2. All fees paid to you by the borrower in connection with the loan, whether direct or indirect and however described. These fees must be clearly and prominently displayed.

## D. Loan funds

You must ensure borrowers don't exceed borrowing limits, and comply with the broker obligations in the Financial Advisers Act 2008 (FAA).

### Minimum standards

1. You maintain adequate systems and procedures to ensure that borrowers comply with any borrowing limits or caps in the regulations.
  2. If you receive, hold or transfer funds from lenders, to fund loans to borrowers, you must comply with the broker obligations in the FAA – this means the funds must be held in trust.
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## E. Debt collection

Debt collection procedures must be fair, orderly and transparent.

### Minimum standards

1. Your systems and facility are supported by effective documentation to ensure loans are legally binding and, if applicable, debt collection can be enforced.
  2. You have an effective debt collection process – you can outsource this to a collection agency, but collection must be 'fair, orderly and transparent'.
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## F. Material issues and complaints

You must have effective processes and procedures to identify and deal with material issues in your business.

### Minimum standards

1. You maintain effective methods for identifying and reporting to FMA any material change of circumstance (as defined in section 410 of the Act) to FMA.
2. You monitor client complaints to ensure they are dealt with fairly. You have systems and procedures to identify trends in complaints – and you investigate and address any issues identified.
3. You are a member of a dispute resolution scheme, as required under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.



## G. Resources and infrastructure

You must have the necessary technological and human resource capacity to provide the P2P lending services.

### Minimum standards

1. You must have effective processes and procedures to maintain sufficient technological and human resources to deliver the P2P lending services.
  2. You regularly review resourcing levels and anticipate any increase in demands, so that resource levels remain appropriate for the scale and complexity of your business (reviews should include outsourced functions).
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## H. Staffing and supervision

You have adequate and effective arrangements to manage and supervise staff and core processes. Your staff are fit for their roles and act professionally.

### Minimum standards

Your arrangements ensure:

1. Staff have the right skills and experience for their roles, and a clear job description that sets out their responsibilities (including authorisation/delegation levels).
2. Roles are designed to support key controls (for example by segregating duties between roles) and enough time is allowed for key processes including compliance activities.
3. Staff are appropriately trained, managed and supervised – you address poor performance and recognise professional conduct.
4. You have appropriate supervisory arrangements, including:
  - Sufficient resources are allocated to supervision
  - Supervisory staff with the right knowledge and experience (including understanding the functions of the roles they supervise)
  - Supervisory staff have the support and authority they need to do the role effectively
  - Any issues identified by supervisory staff are acted on appropriately.

## I. Outsourcing

You must ensure all outsourced functions are adequate, effective and comply with your licence obligations.

### Minimum standards

1. You must conduct due diligence before outsourcing to ensure the provider is an appropriate entity and capable of effectively performing the outsourced function to an acceptable service level. Your considerations may include:
    - The outsource provider's previous experience
    - Public reports and information about their service
    - Reported complaints about them, and their complaint handling procedures
    - Their operating jurisdiction and any protections/controls imposed in that jurisdiction.
  2. You have a proper legal arrangement with the provider, including provisions that enable you to effectively monitor their performance and take appropriate action for non-performance.
  3. Records and information the provider holds are available for inspection by FMA at any time.
  4. You regularly review the outsource arrangement (at a frequency appropriate to the risk involved).
  5. Your performance monitoring programme includes:
    - Checks that the provider's performance meets required standards
    - Triggers for non-performance
    - A plan for steps you will take in the event of non-performance.
  6. **Related bodies** - if you are using a related body to provide part of your licenced operations these outsourcing minimum standards may not be applicable. However, you must have oversight over the related body to ensure your group as a whole meets the minimum standards.
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## J. Records

You must maintain adequate records and provide information to FMA in a timely manner.

### Minimum standards

1. You must have systems and procedures to maintain proper client records.
2. You are required to retain these records for at least seven years – and they must be available for immediate inspection by FMA at any time.

## K. IT systems

Your IT systems used to deliver the P2P service must be secure and reliable. Your arrangements ensure they perform efficiently and the associated risks are managed.

### Minimum standards

1. Your facility is available at almost all times (apart from reasonable scheduled outages for maintenance) and will remain reliable for any foreseeable increase in business.
2. Your IT systems include all necessary functionality to provide your service, and perform the intended processes effectively.
3. You have effective safeguards and controls over the IT systems (and the underlying processes) whether they are built into, or external to, the system.

These include processes:

- To ensure data and system security – and prevent errors or system failure
  - Which take into account risk from human error, technical failure and malicious conduct.
4. You maintain an appropriate (and tested) business continuity plan – including procedures for data back-up and disaster recovery.
  5. You have proper legal arrangements with any third party software providers, including licences for software and contracts for any required maintenance and support.
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## L. Termination of service

You must provide for the orderly administration of loans should you cease business.

### Minimum standards

1. You have effective plans and procedures for the orderly administration of loans if you cease business. For example you may have:
  - A model of income and expenses during a close-down period, and funds set aside to cover the administration costs
  - A service agreement with a reputable third party to administer the loans, and a fund set aside to pay for the service.
2. Where your plan involves assumptions about future costs, or funds available in the future, you must provide us with a letter from your auditor confirming the viability of your plan. This must also confirm that any funds set aside are protected in a bankruptcy situation.

## Part 5. Financial Resources

### Financial resources | Professional indemnity insurance

#### A. Financial resources

You must, at all times, have adequate financial resources to effectively perform the market service covered by the license – and to ensure there is sufficient money for the orderly termination/transfer of clients' portfolios should your business cease.

##### Minimum standards

1. You must have positive net tangible assets (see note 1).
2. You must be able to pay your debts as they become due in the normal course of business (see note 2).
3. At all times, you must maintain an appropriate level of liquid assets for your business – three months of actual or project outgoings, on a rolling basis, with allowance for contingencies (see note 3).
4. You must have adequate and effective systems, policies, procedures and controls to:
  - Constantly monitor your financial resource levels
  - Consistently calculate an appropriate level of liquid assets to hold for your business
  - Assess the risk of your financial resources not being adequate to continue to provide the service, or a serious financial problem occurring
  - Notify FMA if a material change of circumstance occurs, or is likely to occur, in relation to the license – as required in section 410 of the Act (see note 4).

**Note 1:** Your **net tangible assets (NTA)** means your total net assets as they appear in your balance sheet (calculated according to NZ IFRS). Your NTA calculation can't include intangible assets, any client funds you hold, and any related party receivables except those resulting from a transaction done in the ordinary course of business, at arms-length. For the purpose of this calculation we propose to limit related party receivables to no more than 20% of NTA.

**Note 2:** To satisfy yourself you can continue to meet this standard, we expect you to use a suitable **forecasting** mechanism.

**Note 3:** For this purpose, **liquid assets** are defined as cash or cash equivalents, trade receivables realisable within the next three months (on a rolling basis), and financial assets that have a ready market and are valued at current market prices. You must not include any client funds you hold, or any investments you have in the portfolios you manage.

**Note 4:** A **material change** of circumstance includes becoming aware that you will have insufficient liquid assets to meet your liabilities as they fall due.

## B. Professional indemnity insurance

You must maintain an adequate minimum level of professional indemnity insurance cover.

### Minimum standards

1. You must maintain professional indemnity insurance to cover risks related to your market service.
2. Your level of professional indemnity insurance cover should be adequate and appropriate for the nature, scale and complexity of the market service you are licensed for – there is no set minimum cover, it depends on your business.
3. You must have sufficient resources to meet any insurance excess.

## Part 6. Governance

Governance | Culture | Compliance

### A. Governance

You have a high-level body responsible for overseeing compliance with your obligations as a market services licensee, and ensuring appropriate risk management and fair treatment of clients.

#### Minimum standards

1. You must have a clear reporting and governance framework covering all key aspects of the P2P business (or proposed business) including compliance obligations and key risks of the business.
2. You have an 'oversight body' responsible for overseeing compliance – compliance should not solely be the responsibility of risk, compliance or internal audit functions (see note 1).
3. You have appropriate arrangements to ensure your oversight body and other senior managers and directors get timely, sufficient good-quality governance and management information to allow for proper oversight and decision making.
4. Your oversight body considers the adequacy and robustness of its governance and compliance arrangements at least annually.
5. **Related bodies** – your oversight body is able to direct and oversee the provision of market services by any related body operating under your licence (see note 2).

**Note 1:** We expect that the **oversight body** will be the board or a risk committee of the board – or in larger organisations, a committee comprised of senior executives responsible for the P2P lending services plus representatives from legal, risk and compliance areas. In smaller organisations the oversight body could be an individual, providing you still meet the minimum standards.

**Note 2:** For **related bodies** this is likely to include the ability to approve, or require changes to, key processes and controls, and effective processes to ensure that the oversight body is provided with sufficient good-quality governance and management information.

## B. Culture

You have governance and compliance arrangements that promote a culture of compliance with your obligations as a licensee, and ensuring appropriate risk management and fair treatment of clients.

### Minimum standards

1. You have a good compliance culture, supported by systems, policies, procedures and controls.
2. We expect a good compliance culture to include the following:
  - You clearly communicate your conduct expectations to staff, for example through a code of conduct or code of ethics
  - Management actively supports professionalism in their messages to staff
  - Remuneration, reviews, promotions and other incentives recognise professionalism and compliance, not just the achievement of revenue, cost or profit targets
  - You have processes to identify and manage conflicts between the interests of the licensee (or individual staff) and clients' interests – and you quickly resolve any issues in a way that is fair to clients and reasonable for the licensed business
  - You allocate adequate time and resources for training, supervision and compliance activities
  - Management encourages staff to report breaches or inappropriate behaviour, and deals appropriately with staff who report matters (for example through an independent whistle-blowing policy)
  - Management willingly engages with relevant regulators in an open and honest manner, and are responsive to any regulatory concerns they may raise.
3. **Any related bodies** operating under your licence must also promote a culture of compliance, appropriate risk management and fair treatment of clients.

## C. Compliance

You have adequate and effective arrangements for challenging and testing your own compliance, the compliance framework and the outcomes.

### Minimum standards

#### 1. Compliance assurance

You must have adequate and effective arrangements to challenge and test the design and operation of processes and controls, and the adequacy of governance and management information (your compliance assurance programme).

Your compliance **assurance program** goes beyond the day-to-day controls for key processes, by including more in-depth testing of processes and controls including:

- The testing (and the design of the testing) is done independently of those involved in day-to-day processes and oversight – for example testing is done by a separate compliance or internal audit function, or by an external operation
  - You allocate sufficient, appropriate resources to planning and carrying out the programme, and ensure those involved have the skill and experience to carry out the work
  - Your compliance assurance programme is approved by your oversight body
  - Your oversight body is kept updated about progress against the compliance programme – you also report significant findings to them and follow up on remedial action taken.
2. Your compliance monitoring covers both substantive outcomes and procedural correctness.

#### 3. Related bodies

If you have related bodies operating under your licence, they must also have a compliance assurance programme, and your oversight body should:

- Be responsible for, or have significant input into approval of, these programmes (at least to the extent they relate to the licensed service)
- Have adequate information and sufficient authority to monitor progress, consider significant findings, and ensure appropriate remedial action is taken.



## Part 7. Licence conditions

### A. Standard conditions

If we grant you a P2P lending service licence, it will contain conditions that support your licensee obligations. These are the standard conditions we are proposing to include. The regulations may contain further standard conditions.

1. **Skills and expertise**

You, or any related body covered by your licence, must inform us whenever there is a change in the senior management team.

2. **Outsourcing**

If you outsource a process/system necessary to the effective and proper running of the P2P lending service (or any other licensee obligation) you must have a legally binding agreement with the provider. This must allow both you and FMA access to all the information needed for monitoring.

3. **Regulatory returns**

You must provide us with the information we **need** to monitor your on-going capability to effectively perform the P2P lending service in accordance with the applicable eligibility criteria in the Act. This will include updated information on the nature, size and complexity of your P2P lending service. Information will need to be provided in accordance with any Regulatory Return Framework and Methodology we issue under subpart 4, part 8 of the Act.

4. **Financial resources**

You must continue to satisfy the minimum standards for financial resources, and an external qualified auditor will need to review and confirm your compliance annually.

5. **Governance**

You must have, at all times, adequate and effective systems, policies, processes and controls that are reasonably likely to ensure you will perform the market services you are licensed for in an effective manner.

6. **Compliance**

You must maintain a compliance governance document. This must identify the principal risks and outline the key processes and controls relied on by your oversight body (and board, if different) to ensure you comply with your obligations and adequately manage the risks.

Your compliance governance document will need to:

- Be approved by the oversight body
- Be kept up to date, and periodically reviewed by the oversight body
- Reflect your business model and processes, compliance and governance arrangements.

Your governance and compliance arrangements must be substantially the same, or better than, those described in your compliance governance document at the time you applied for your licence (or any later version supplied to us).

## B. Specific conditions

We may also set extra licence conditions for individual entities on a case by case basis, for example:

### 1. Limits

If you request a limit on your licensed activity, or can only demonstrate the capacity to provide an effective service within certain parameters, we may set limits on your licence.

## The next step

### How do I make a submission?

Please use the form on the next page – this gives the details of what you need to do. Forms must be submitted electronically in both PDF and word formats and emailed to [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz) – please put 'Feedback P2P standards and conditions' in the subject line.

Alternatively, you can make an online submission on our engagement site [www.talktous.fma.govt.nz](http://www.talktous.fma.govt.nz). You need to register to be able to use the site.

**Submissions close on 12 December 2013.**

### Where can I get more information?

You'll find more information about the changes on our website [www.fma.govt.nz](http://www.fma.govt.nz), or at the Ministry of Business Innovation and Employment site [www.mbie.govt.nz](http://www.mbie.govt.nz)

If you have questions about the licensing consultation process, please get in touch.

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Manager Compliance Monitoring Framework

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## Feedback: Licensing P2P lending service providers Draft minimum standards and licence conditions

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz) with 'Feedback P2P standards and conditions' in the subject line. Thank you. **Submissions close on 12 December 2013.**

Date: \_\_\_\_\_ Number of pages: \_\_\_\_\_  
 Name of submitter: \_\_\_\_\_  
 Company or entity: \_\_\_\_\_  
 Organisation type: \_\_\_\_\_  
 Contact name (if different): \_\_\_\_\_  
 Contact email and Phone: \_\_\_\_\_

Part#	Section#	Paragraph#	Comment	Recommendation
<i>You don't need to quote from the consultation document if you use part &amp; paragraph numbers. You may attach extra pages - please label each page with your name &amp; organisation.</i>				

**Feedback Summary** – if you wish to highlight anything in particular

**Please note:** Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

**Thank you for your feedback – we appreciate your time and input.**