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Financial Sector Review Submission

A very important emerging sector that should be considered by the Financial Sector Review is peer-to-peer lending. Peer-to-peer lending is the practice of lending money to consumers or businesses through online services that match lenders directly with borrowers. Since the peer-to-peer lending companies offering these services operate entirely online, they can run with lower overhead and provide the service at a lower cost than traditional financial institutions. Investors (typically individuals) often earn higher returns compared to savings and investment products offered by banks, while borrowers can borrow money at lower interest rates, even after the P2P lending company has taken a fee for providing the match-making platform and credit checking the borrower.

This sector, until 2016, has never existed in Canada despite its' clear ability to boost the Canadian economy. In markets across the globe, peer-to-peer lending platforms have been growing exponentially for almost 12 years and are reshaping the way that consumers and small businesses access financing.

Below, we have summarized four key items that we believe would broadly strengthen the peer-to-peer lending sector in Canada, creating jobs and boosting the Canadian economy. More broadly, we believe the following measures would promote innovation and competition in the financial services sector in Canada.

1) Economic Development

The first area of support that could be provided by government is through direct investment into SMEs. There is clear data which shows that in Canada, just like in many other jurisdiction, SMEs do not have adequate access to financing. One very simple way for government to help support the growth of SMEs would be to directly invest in every loan that is facilitated through a p2p marketplace like Lending Loop. In the UK, the government committed to fund 10% of every loan on Funding Circle that goes to an SME (https://www.gov.uk/government/news/new-40-million-investment-by-british-business-bank-to-support-450-million-of-lending-to-smaller-businesses). Given that Canada is more than 10 years behind in this industry, it would be fantastic to see the government provide a greater level of support by injecting investment into small businesses through peer-to-peer lending platforms.

Another specific way that would generate economic activity via p2p lending in a Canadian context is to allow non-chartered banks and credit unions to offer the Canadian Small Business Financing Program (CSBFP). This requires a broader change-of-mindset of allowing new entrants the ability to offer Government-supported programs such as the CSBFP.

A report published by the Center for Economics and Business Research analyzed the economic impact of peer-to-peer lending and showed that one UK p2p lending platform for SMEs has been directly responsible for boosting the UK economy by £2.7 billion, building 2,200 new homes and creating 40,000 new jobs (https://www.cebr.com/reports/funding_circle/). This is evidence that by increasing direct investment through this sector, the government can directly boost the economy through small business which has a multiplicative economic impact.

2) Tax Incentives

Another important growth driver for the sector internationally has been driven by tax incentives for middle class investors to allocate their funds to this asset class. This means that unutilized dormant capital moves out of banks and directly into the hands of small business owners. In the UK, this was achieved through the development of an ISA, the equivalent of TFSA, specifically made for this investment class (https://innovativefinanceisa.org.uk/). In Canada, this could be achieved through something similar (ie. A P2P TFSA), or alternatively, some other form of incentivization such as investment tax credits that can minimize losses and boost gains.

Not only does this directly help boost small business growth by promoting direct investment, it also has a multiplier effect because investors typically re-invest their earnings in p2p platforms. This means that the tax-free interest goes back into other small business borrowers which further expands the positive benefits of the p2p model.

3) Regulatory Burden

While it is a positive development that Lending Loop was given permission to temporarily operate this business model by the securities regulators, there are still many regulatory inconsistencies that exists because of mismatched regulation. For p2p lending platforms like Lending Loop, we will need to work with government stakeholders and regulators to create a new appropriate and proportionate regulatory regime specifically designed for peer-to-peer lending. This should not only reduce compliance costs; it should also help safeguard areas of the business that are currently not protected by regulations.

The best way to do so would be to transfer the regulatory management outside of the bounds of traditional securities regulations and into the hands of a new regulator tasked with developing regulation for innovative financial business models. The regulatory approach taken should be through principles based regulation as a pose to the rule based regulation which is embedded in Canadian securities regulations. One important element to any new regulatory approach is provincial harmonization. The current securities structure of 13 provinces makes it incredibly expensive and complex to do business in all jurisdictions. Additionally, the economics of a new entrant offering their product or service in smaller jurisdictions means some Canadians will not benefit from the competition new entrants create.

4) Payments Infrastructure

The payments infrastructure in Canada is controlled by the dominant financial institutions. In the absence of highly disruptive changes to payment and money transfer networks (ie. Blockchain), the process for new upstarts to transact with the clients of other financial institutions should become a lot easier. Right now, the only way to access this network is through another institution or by becoming a depository institution. It should be made easier for new businesses that do not risk the capital of the depositors (without their consent) to be able to transfer money in or out of transitional bank accounts. This could be facilitated through rule changes or with the assistance of intermediaries such as Interac to develop transfer networks for bank deposits rather than networks built solely for payments.