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ALTERNATIVE FINANCE

Alternative Finance Trends in South Africa and the Implications for Financial Regulators

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ALTERATIVE FINANCE TRENDS IN SOUTH AFRICA AND THE IMPLICATIONS FOR FINANCIAL REGULATORS

CONTENT

EXECUTIVE SUMMARY

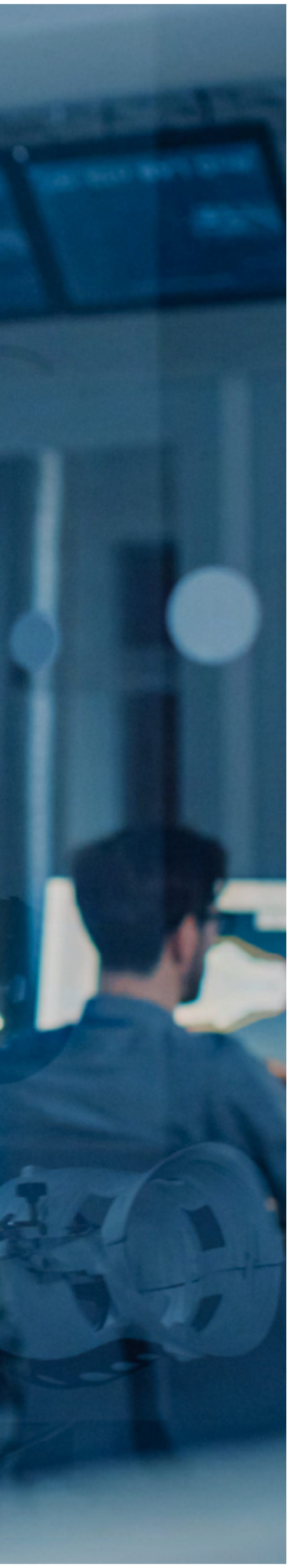
The term "Alternative Finance" refers to financial products and services that are developing outside of the traditional, regulated banking and capital market sectors often offered to customers using digital channels, instruments and systems. Typical Alternative Finance instruments ranges from, (1) asset-based finance, (2) equity-based finance, (3) alternative debt and (4) hybrid instruments.

Globally, Alternative Finance activities have experienced a largely upward trajectory over the years, with China initially dominating the global alternative finance market up until 2018, where the rest of the globe increased its share.

Alternative Finance still remains largely unregulated, although many jurisdictions have taken notice of this financial activity and have consequently begun to develop bespoke regulation. Despite the increased focus from regulators most Alternative Finance activities are still not formally regulated in most jurisdictions.

The top four Alternative Finance use-cases identified in the study include, (1) Invoice trading, (2) Crowd funding, (3) Balance sheet lending and (4) P2P marketplace lending. The study identified several key enablers to unlocking the potential of Alternative Finance including digital and financial literacy, a sound financial system, the development of bespoke and enabling Alternative Finance regulations, and internet connectivity.

Based on the findings from the study, a list of considerations were identified for financial regulators to reflect upon. The considerations are aimed at minimising the risks and eliminating the barriers to entry around Alternative Finance activities. These considerations include addressing risks relating to consumer protection, cyber security and data privacy, money laundering and other risks as well as barriers such as lack of awareness, lack of enabling regulations and the lack of innovative products.



INTRODUCTION

What is Alternative Finance

Alternative Finance refers to financial products and services that are developing outside the traditional, regulated banking and capital market sectors using innovative and predominately online channels, instruments, and systems.

Alternative Finance products and services tend to differentiate themselves from traditional financial products in several ways. Typical traditional financial products include financial instruments such as bank loans, overdrafts, mortgages, credit lines, the use of credit cards and many more. This type of finance offers moderate returns for lenders and is therefore appropriate for low-to moderate risk profiles. For example, firms that are characterised by stable cash flow, modest growth, tested business models, and access to collateral or guarantees. Alternative financing instruments alter this traditional risk sharing mechanism.

There has been an increase in a range of alternative financing options available to Small Medium Micro Enterprises (SMMEs) and consumers during the past 10 years. However, some of these options are still at an early stage of development or in their current form, are accessible only to a small share of SMMEs and consumers. There is also insufficient awareness and understanding on the part of SMMEs and consumers of these alternative instruments and as a result, their modalities and operations has held back their broader use. Improving knowledge of the full range of financing instruments for consumers and SMMEs represents a first step towards broadening access to these finance options. Table 1 below provides a detailed breakdown of Alternative Finance instruments.

Table 1: Alternative finance instruments

Alternative Finance instruments			
Equity instruments	**Alternative Debt instruments**	**Asset based finance**	**Hybrid instruments**
· Private Equity · Venture Capital · Business Angels · Crowdfunding Equity · Initial Coins Offering · Specialised platforms for SMEs listing	· Corporate bonds · Securitised debt · Covered bonds · Private placements · Crowdfunding (debt)	· Asset based lending · Factoring · Purchase Order Finance · Warehouse Receipts Leasing	· Subordinated loans/ bonds · Participating loans · Profit participation rights · Convertible bonds · Bonds with warrants · Mezzanine finance

Source: OECD 2015

INTRODUCTION

Alternative Finance key enabling factors

Across the world, Alternative Finance activities are being driven by factors such as, (1) enabling regulatory and supervisory regime, (2) financial literacy, (3) growth in the Fintech sector, (4) existence of solid financial ecosystem system and (5) reliable and widespread internet penetration.

The regulatory and supervisory regime is of crucial importance for the development of Alternative Finance market. However, a careful balance needs to be found to ensure investor protection and limit the risks of a collapse of platforms due to malpractice and fraud, while avoiding overregulation, specifically with respect to licencing requirements.

Financial literacy is another key enabler to Alternative Finance market. The development of Alternative Finance market rests on the awareness among SMMEs and consumers, their financial acumen and how much they know about these products.

The importance of solid financial ecosystem should also be emphasised. There is a role for governments led initiatives that can combine and coordinate the efforts of different Fintechs in banking, credit provision, payment systems, telecom companies, e-commerce and BigTech. This provide the underlying conditions for a coherent and vibrant ecosystem that will promote both innovation and usage levels by individuals and companies.

Fintech-enabled financing is expanding rapidly in various regions of the world, recording exponential growth rates for some Fintech financing instruments over the last few years in many countries. Within these developments, Alternative Finance activities have featured prominently.

Reliable and widespread internet penetration as well as access to affordable broadband has contributed to the development of Fintech ecosystem, which has resulted into the development and growth of Alternative Finance activities.

Characteristics of Alternative Finance models

Leading Alternative Finance business models have four key characteristics in common:

They offer funds in a speedy manner:

Bank finance, for instance, can take weeks or months, from application to approval, but many forms of Alternative Finance can approve the funds in a single day.

More leniency is afforded to businesses and consumers:

Alternative financiers do not display the same level of intense scrutiny as banks. There is also full responsibility on the part of the business owner to use their funds as they see fit, rather than being dictated to about how the money is spent.

They offer access to wide range of funders:

Alternative financiers allows businesses and consumers to connect to a large pool of investors to obtain relevant funding (rather than tie up to a single bank).

They are mostly technology enabled:

Mostly conducted via an online platform by Alternative Finance companies, processes are usually automated with minimal intervention.

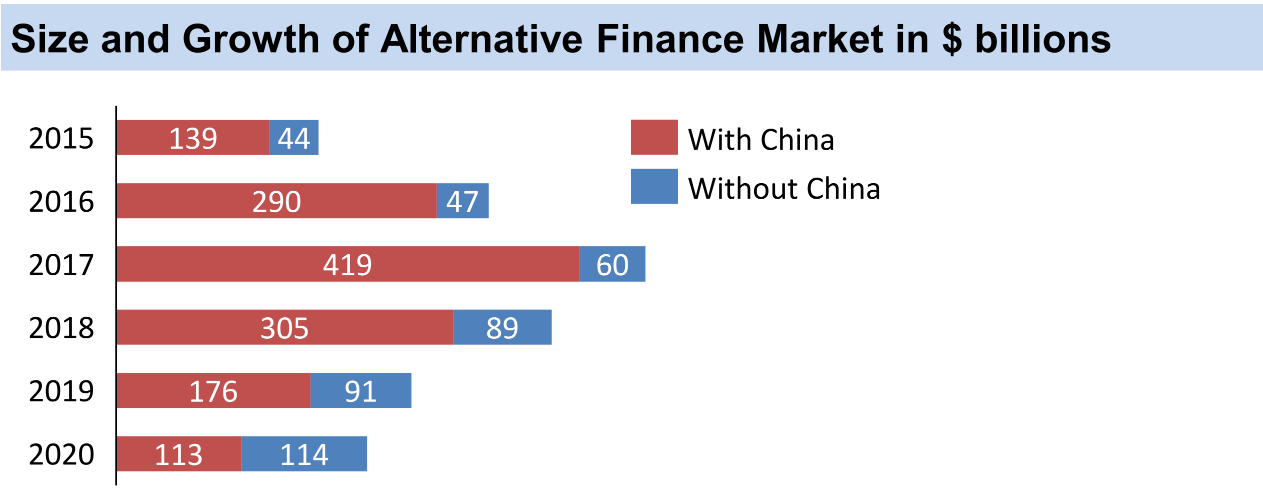
Generally, Alternative Finance distinguishes itself with features such as an absence of lengthy application forms, low documentation, almost no collateral and/or minimum credit score requirements, high approval rates, and fast funding, even for cash flow and asset finance needs.

Alternative Finance trends

Globally, Alternative Finance activities have grown over the years. China initially dominated the global online alternative finance market up until 2018, once accounting for 48% of the global share. However, local market developments in China and regulatory changes have led to a decline in Chinese Alternative finance volumes and global market share, where it now only accounts for 1%.

In contrast the rest of the global online Alternative Finance market has grown consistently over the past three years, particularly in regions such as the US, Canada, and UK. This is illustrated below in Figures 1 and 2.

Figure 1:



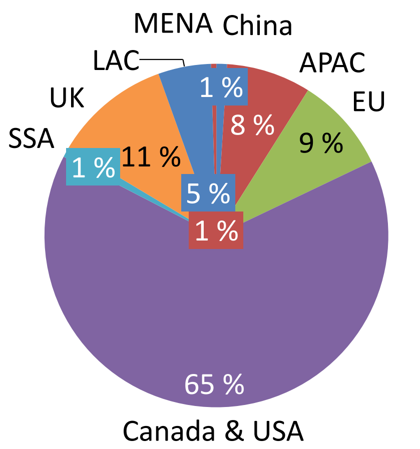
Source: The Global Alternative Finance Report 2021

Looking at various regions, in 2020 the largest regional alternative market was the US and Canada ($73.93billion) with the US being the largest national market with $73.62 billion, which accounted for 65% of global online Alternative Finance market volume. This is followed by the United Kingdom (UK) ($12.64 billion), Europe excluding the UK ($10.12 billion), the Asia Pacific excluding China ($8.90 billion), Latin American Countries (LAC) ($5.27 billion), Sub-Saharan Africa (SSA) ($1.22 billion), China ($1.16 billion) and Middle East and North Africa (MENA) ($0.59 billion) .

2 Available:https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf

Figure 2:

Market Share of Alternative Finance by Region

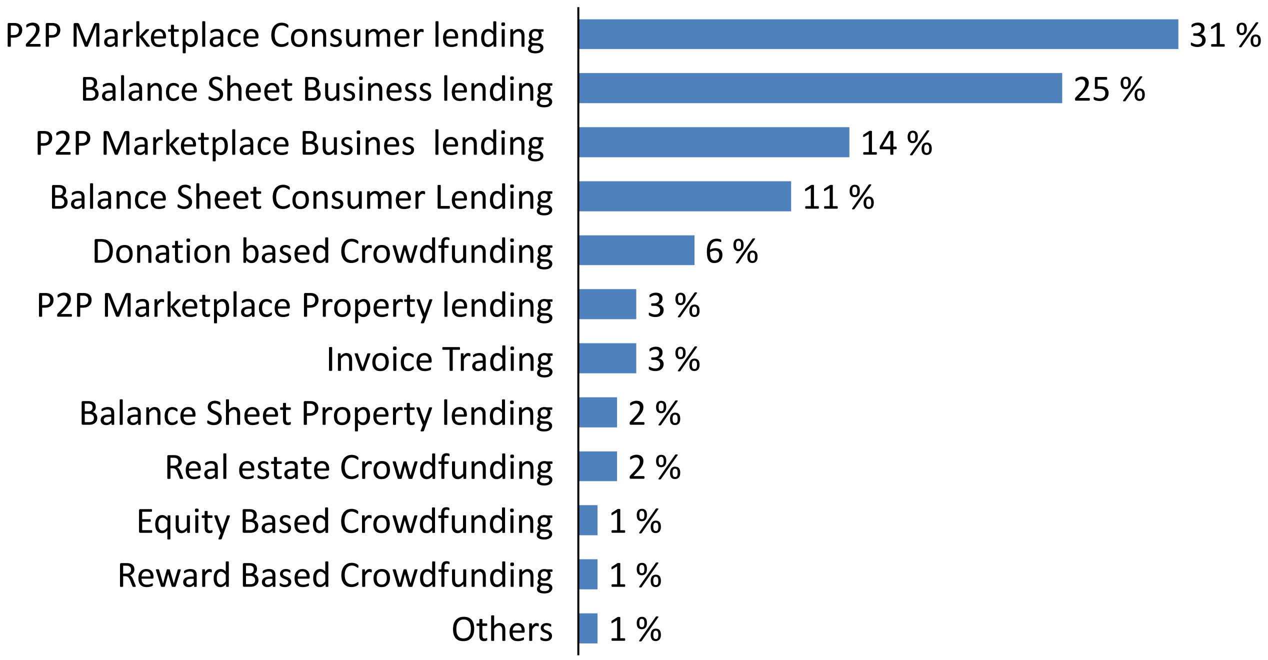


Source: The Global Alternative Finance Report 2021

The largest model globally in 2020, was P2P/Marketplace Consumer Lending, accounting for 31 % of the overall value of alternative finance market. This was followed by Balance Sheet Business Lending 25%, P2P Market Place Business Lending 14%, Balance Sheet Consumer Lending 11%, Donation Based Crowdfunding 6%, P2P/Marketplace Property Lending and Invoice Trading 3 % respectively. The Donation-based Crowdfunding model has experienced exponential growth globally in 2020. The leap in annual growth, can be attributed largely to the flurry of Covid-19 related charitable, community and health-related online fundraising activities around the world .

Figure 3:

Global Alternative Finance Market Value by business model in USD Billions



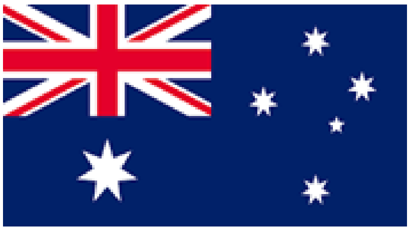
Source: The Global Alternative Finance Report 2021

3 Available:https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf

Jurisdiction analysis

Alternative Finance regulations remain largely nascent across the globe, however bespoke regulations have been developed by some jurisdictions. Box 2 below gives an overview of some of the regulatory approaches taken by various jurisdictions to address Alternative Finance activities.

In China, the central bank, the People's Bank of China and China Bank and Insurance Regulatory Commission have initiated a sweeping rectification programme to regulate P2P/Marketplace lending. Under the new rules: (1) Microlenders are not allowed to extend online microloans when proceeds are not earmarked for a specific purpose; (2) Financial institutions cannot provide funding to marketplace lenders for their loans;(3) All P2P/Marketplace lending platforms must become small loan providers (i.e. licenced providers) within two years;(4) Lending platforms must meet a minimum capital requirement of $7 million to become a regional small loan provider and $141 million to transition into a small lender qualified to operate nationwide;(5) All marketplace lenders must adhere to AML/CFT obligations;(6) P2P/Marketplace lenders that contained serious credit risks and fraudulent ones would be banned from making the transition and forced to close.



In Australia, Alternative Finance transactions are generally regulated within the framework of the Corporations Act 2001. In terms of P2P lending, the Australian Securities and Investments Commission (ASIC) advises investors that P2P lending platforms are managed as investment schemes. Any alternative lender seeking a financial licence to operate in the Australian retail financial market is obligated to seek approval through ASIC, or alternatively, can operate under an existing licence via a third party.

In Brazil, the CMN National Monetary Council (CMN) issued a resolution to increase accessibility to equity and P2P financing in 2018. The resolution provides for the creation of two new types of financial institutions to fund clients through electronic platforms. Direct credit companies are allowed to fund their loans exclusively through equity capital. P2P loan companies are allowed to connect lenders and borrowers and to intermediate the negotiation through digital platforms.

The United Kingdom was one of the first nations to create bespoke regulation for crowdfunding activities in 2014. The regulating body that monitors and supervises crowdfunding activities in the UK is the Financial Conduct Authority (FCA).

4 Available: https://www.afi-global.org/wp-content/uploads/2021/01/AFI_MSMEs_survey-report_AW_digital_0.pdf
5 Available: https://www.monash.edu/__data/assets/pdf_file/0008/2326094/Cutivating-growth.pdf
6 Available: https://www.afi-global.org/wp-content/uploads/2021/01/AFI_MSMEs_survey-report_AW_digital_0.pdf
7 Available:https://www.crowdfundinsider.com/2016/07/88046-case-regulatory-evolution-review-uk-financial-conduct-authoritys-approach-crowdfunding/

ALTERNATIVE FINANCE USE CASES

There are several prominent Alternative Finance use cases. The study will zoom in on four of the most prominent Alternative Finance use-cases. These use cases include; (1) P2P/ Market Place Lending, (2) Balance Sheet Lending, (3) Invoice Trading and (4) Crowd Funding.

1) The P2P/Market place lending use case entails consumer lending where individuals and/or institutional funders provide a loan to a consumer, business lending where individuals and/or institutional funders provide a loan to a business and property lending where individuals and/or institutional funders provide a loan, secured against a property, to a consumer or business.

2) Balance Sheet lending use case entails consumer lending where a platform entity provides a loan directly to a consumer borrower, business lending where a platform entity provides a loan directly to a business borrower and a property lending where the platform entity provides a loan, secured against a property, directly to a consumer or business borrower.

3) Under Invoice Trading, individuals or institutional funders purchase invoices or receivables from a business at a discount. The platform connects enterprises looking for financing with investors looking to earn higher short-term yields with lesser risk. The invoice discounting platforms provides businesses and their suppliers with quick access to working capital.

4) The Crowdfunding use case consists of, Real Estate Crowdfunding, Equity based Crowdfunding, Donation based Crowdfunding and Reward based Crowdfunding. Under Real Estate Crowdfunding, individuals or institutional funders invest money for real estate investment. Regarding Equity Crowdfunding individuals or institutions invest in an early-stage unlisted company in exchange for shares in that company. With Donation based Crowdfunding, a large number of contributors individually donate a small amount of money in a project and in return, may receive token rewards that increase in prestige as the size of the donation increases. In Reward based Crowdfunding individuals donate to a project or business with the expectation of receiving a non-financial reward in return, such as goods or services at a later stage. Below we provide an example of some Alternative Finance cases around the world.

Box 3: Alternative Finance has the potential to play a significant role in growing entrepreneurship activities in the economy.

Thundafund

Crowd Funding

Thundafund is one of the first and largest crowdfunding platforms in South Africa. Thundafund believes that by changing the way entrepreneurial funding works, and by making this transparent and inclusive, they can build trust and loyalty between entrepreneurs and their customers thereby growing economies and creating jobs.

Thundafund enables project creators (e.g. entrepreneurs) register their idea on the platform and sponsors can then register and make contributions to the projects. The Thundafund team works with the project creator to understand the idea or project and its funding needs.

Each project then devises a variety of project related items, known as rewards, that will be presold to backers in turn for their funding contribution. These rewards include retail items, recognition, and experience/exposure. All projects on Thundafund are required to reach their tipping point before their project closes in order to receive all their funds. If their target is not reached all backers of the project will be reimbursed minus the banking fees. Once a project is successfully funded, Thundafund receives a commission on the final amount.

Through this initiative, entrepreneurs are able to test their ideas and build a base of supporters. Entrepreneurs can also get more than capital support, as backers usually want the business to succeed and provide advice and assistance. It is a risk-free model, allowing project creators to raise awareness within their market or audience by pre-selling the product before engaging in significant resource.

Source: Fintech Scoping in South Africa 2019

Box 4: Alternative Finance has the potential role to play in increasing access to finance and drive economic growth.

kredX

Invoice Trading

KredX (formerly Mandii) is an online invoice discounting marketplace for SMMEs lending. The platform connects enterprises looking for financing with investors looking to earn higher short-term yields with lesser risk. The KredX invoice discounting platform provides businesses and their suppliers with quick access to working capital. As an off-balance sheet solution, the KredX invoice discounting platform allows businesses to use unpaid invoices as a collateral to get immediate working capital, thereby helping in growth and expansion.

Borrowers can sign up, upload payment pending invoices or post-date instruments of their customers, select from among the best bids available and receive funds. Investors can view invoices/PDIs from companies along with credit profiles to post their bids against them. Post the tenure, investors can get the funds directly to their account. The company receives a commission from both the parties once the trade is settled.

KredX's working capital solution helps businesses gain quick access to funds, without the need to pledge any collaterals, thus providing liquidity for growth and expansion through a healthy cash flow balance. This solution allows businesses to take care of all short-term liabilities without the need for physical assets by unlocking money tied up in unpaid invoices via invoice discounting

08 Available: https://tracxn.com/d/trending-themes/Startups-in-Internet-First-Invoice-Financing

Box 5: Alternative Finance has the potential to play a significant role in increasing consumers and SMMEs choices.

fundera

Market Place Lending

Founded in 2013, Fundera is an online marketplace for small business financial solutions. With Fundera, a small business owner can apply for financing with more than 30 different lenders with one easy application. Fundera offers guidance for small business owners to secure solutions for any of their financing needs, from credit cards to SBA loans and everything in between. They partner throughout every stage of their business, helping them weigh the best-fit financial options based on their current needs and eligibility. Their combination of technology and financial expertise ensures business owners make smart business decisions.

Because Fundera works with several different funders, it does not have any specific requirements regarding how long you have been in business, how much revenue you make, what your personal credit score is, or any other business characteristics. Each of Fundera's partners has its own requirements regarding business characteristics; as such, you may not be eligible for certain products. If you make an account and find you are not eligible for the products you are interested in, Fundera offers an eligibility tracker that can inform you when you do qualify for new products.

Other Fundera benefits include, (1) Easy-to-use customer interface Fast time from application to funding Provides a seamless and simple online application process; (2) Lower fees for borrowers with no early settlement penalties; (3) Giving borrowers access to a number of investors and (4) Giving investors access to a new asset class, which is alternative lending for high growth medium to small businesses .

Box 6: Alternative Finance has the potential to play a significant role in deepening financial access.

iwoca
instant working capital

Balance Sheet Lending

Iwoca Ltd is an online Fintech company based in London. It offers credit facilities to small businesses trading in the UK and Germany via an automated lending platform. They aimed to offer custom-built loans to small businesses, who usually struggled with fair access to finance from big banks. To start with, these were exclusively e-commerce businesses, but in April 2014, Iwoca began lending to all types of small businesses. By July 2015, it was reported to have seen 250% year-on-year growth in issuance.

Iwoca provides credit lines of up to £200,000 and business loans of up to £250,000. It uses various machine learning models to automatically assess businesses based on data taken directly from Xero, eBay, Amazon, PayPal, Sage Pay, business bank accounts and other online and offline platforms. It's also integrated its credit API with the Tide bank. A 3% monthly interest rate and maximum loan term of 12 months are typical.

Their working capital loans have helped thousands of businesses to realise their true potential. Increase in speed and accuracy with which applications are assessed and decisions made. Increase in employment and economic growth .

09 Available: https://www.fundera.com/
10 Available: https://en.wikipedia.org/wiki/Iwoca

ALTERNATIVE FINANCE SURVEY RESULTS

During 2021, the FSCA conducted a survey to gauge the extent of Alternative Finance activities in SA. Several Fintechs were interviewed regarding (1) the most prominent Alternative Finance instruments in SA (2) the top Alternative Finance use cases in SA (3) the main barriers to Alternative Finance in SA, (4), and key interventions required to support/grow Alternative Finance activities in SA (5) the main benefits and risks associated with Alternative Finance, and (6) the Impact of Covid-19 had on Alternative Finance in SA. The results from the survey are presented below under figure 3 to 10.

FIGURE 3: THE MOST PROMINENT FINANCIAL INSTRUMENT UNDERLYING ALTERNATIVE FINANCE OFFERINGS IN SOUTH AFRICA

Equity based instrument is the most prominent financial instrument underlying Alternative Finance offering in SA, followed by Asset based finance, Alternative debt and Hybrid instruments. The prominence of Equity-based instrument is being driven by Crowd funding equity, Venture capital and Private equity investors activities. Asset based finance instrument such as purchase order financing is driving growth in Assets based finance. Purchase order financing is gaining popularity in SA within the SMMEs sector. This is a testament to the fact that, although SMMEs are having bank accounts, they are still struggling to get funding from traditional finance institution and Alternative Finance instruments such as purchase orders finance are filling the gap.

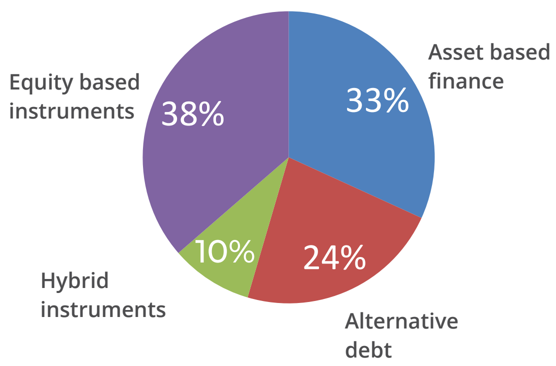
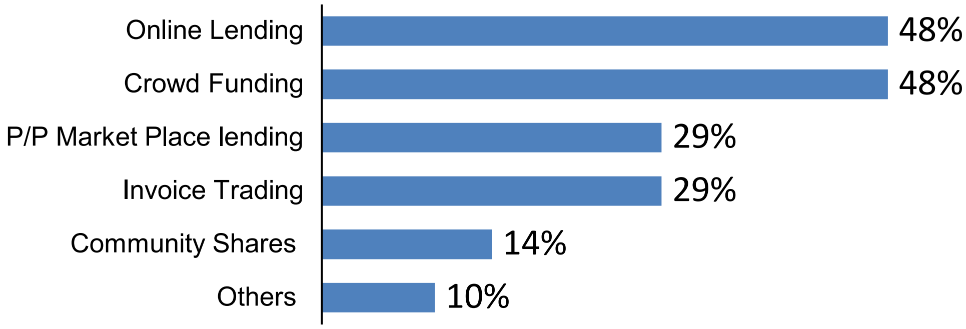
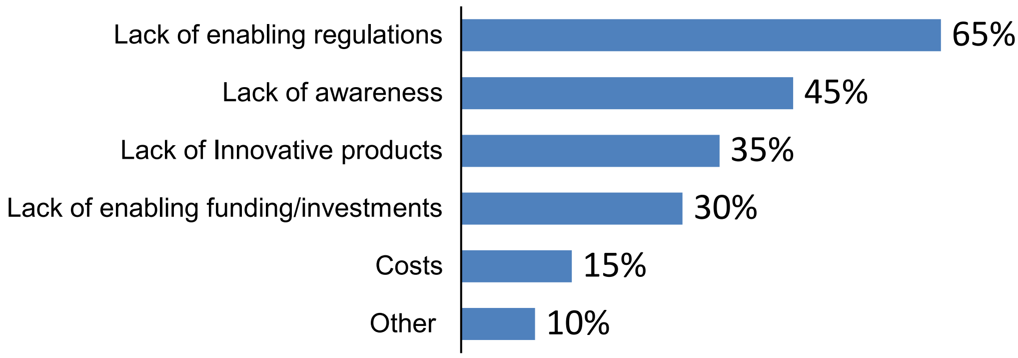


FIGURE 4: MOST PROMINENT ALTERNATIVE FINANCE USE CASES IN SOUTH AFRICA



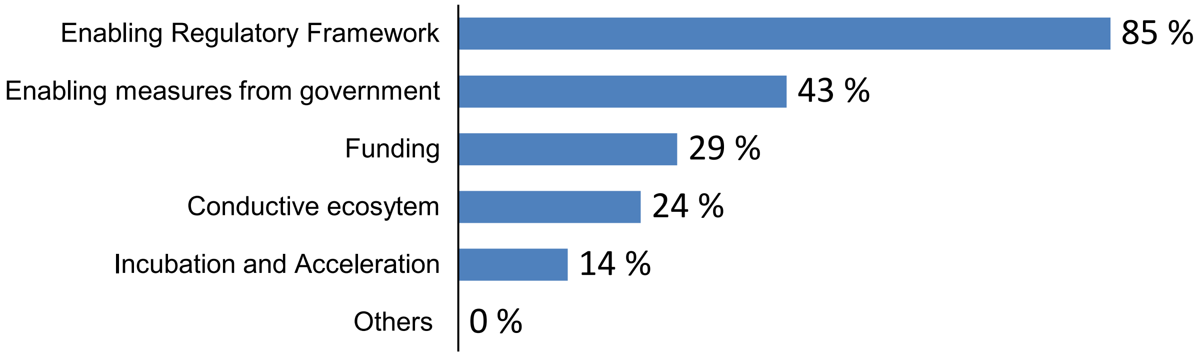
Top 2 most prominent Alternative finance use cases in SA are Online lending and Crowdfunding. This is followed by Invoice trading and P/P marketplace lending as well as community shares. Online lending is skewed towards the consumer market, especially unsecured lending space. Crowdfunding has always existed in SA in a form of Stokvels and nowadays it is technologically backed. Invoice trading, P/P marketplace lending and community shares use cases are still in an early phase of development in SA and are expected to mature in the near future.

FIGURE 5: BARRIERS FOR CONSUMERS TO ACCESS ALTERNATIVE FINANCE IN SOUTH AFRICA



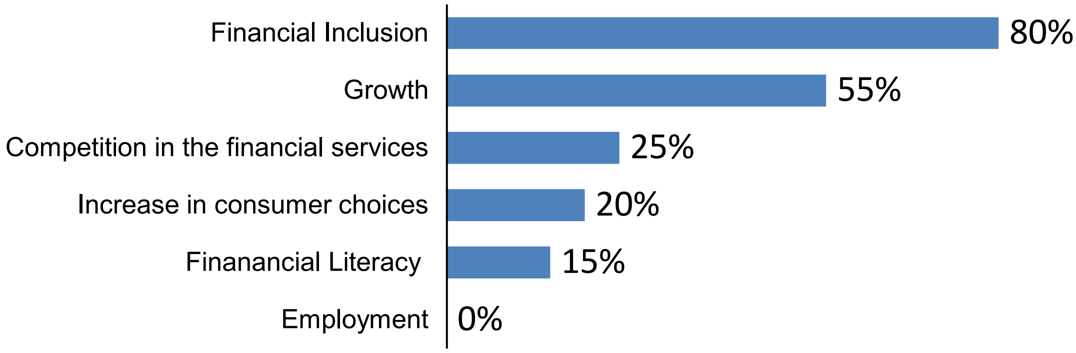
The dominant factors driving the relatively low take-up of alternative financing in SA include, lack of enabling regulation, followed by lack of awareness. The absence of regulations governing Alternative Finance makes it difficult for people to trust the products, while lack of awareness reflects the inefficiency of the channels of information for improved communication to consumers. Consumers and SMMEs are mostly not aware that there are other forms of financing beyond their tradition banks. Lack of innovative products and investments have also been identified as some of the barriers for consumers to access alternative financing in SA.

FIGURE 6: INTERVENTIONS THAT SHOULD BE PUT IN PLACE TO SUPPORT ALTERNATIVE FINANCE IN SOUTH AFRICA



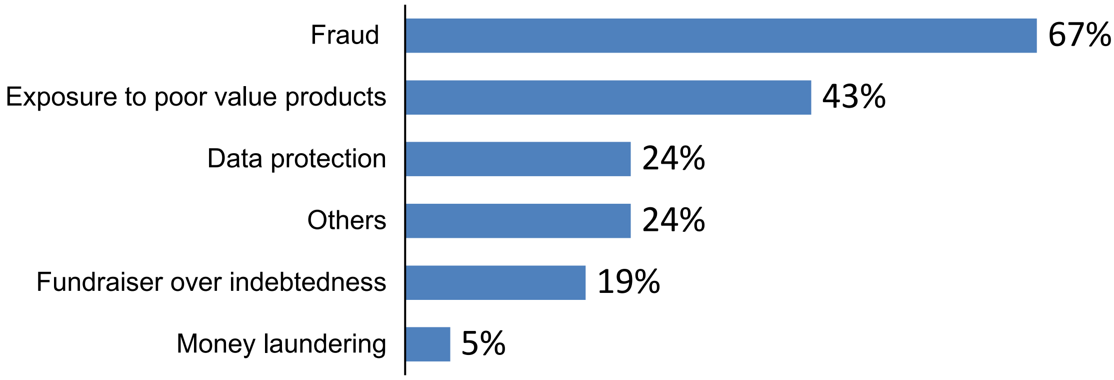
Enabling regulatory frameworks and supporting measures from government were the top interventions identified by Fintechs to support Alternative Finance in SA. These were followed by funding and conductive ecosystem. Some respondents indicated that ensuring that SMMEs have adequate access to financing should be government's highest priority since SMMEs are the greatest generators of employment in the economy.

FIGURE 7: KEY BENEFITS ASSOCIATED WITH ALTERNATIVE FINANCE



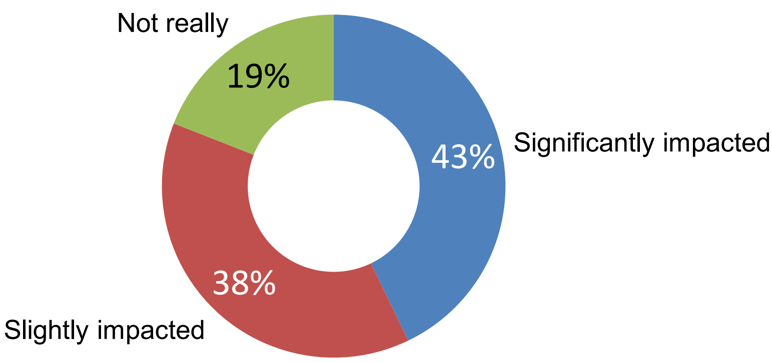
The survey results show that financial inclusion, followed by growth are the leading benefits associated with alternative finance. This is because traditional financial institutions have struggled to find cost-effective, profitable approaches to serving both the SMMEs market and low-income consumers and Fintechs have found ways to fill the gap. Alternative Finance products are making it possible for SMMEs to acquire much required capital to drive growth in their operations, something which is very difficult to attain if they follow the current traditional finance funding models. Competition in the financial services and increase in consumer choices are also some of the most prominent benefits associated with Alternative Finance.

FIGURE 8: KEY RISKS ASSOCIATED WITH ALTERNATIVE FINANCE



Large proportion of the respondents indicated that fraud and exposure to poor value products are major risks associated with Alternative Finance to consumers and SMMEs. This was followed by data protection and other risks e.g. (operational risk, market risk, cyber security risk). Fraud is mostly being driven by lack of proper due diligence on issuers of Alternative Finance products, lack of consumer education about the products and absence of regulations. Poor value products risk being driven by the fact that some of these Alternative Finance products are highly priced and there seems to be no co-relation between the risk and pricing of the product.

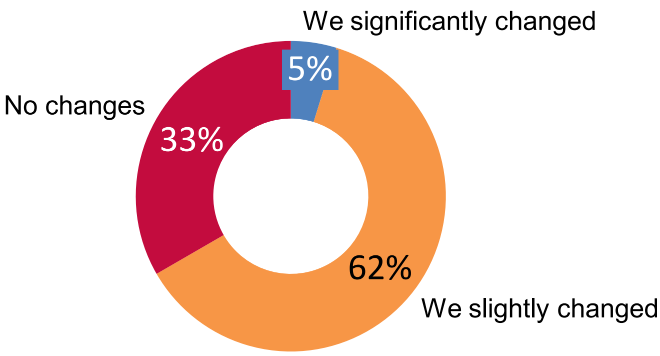
FIGURE 9: HOW ORGANISATIONS WERE IMPACTED BY COVID-19 IN THE PAST TWO YEARS?



Large proportion of respondents indicated that they were significantly impacted by Covid-19 in a negative way. This was due to drying up in funding as most investors became risk averse during this Covid-19 period. Business was also very low as most SMMEs cut back on their operations and consumer demand was also low. This was further exacerbated by the fact that most Fintechs are still in a building phase, and they did not have enough resources to cushion themselves against pandemic of this proportion.

To those Fintechs who were slightly impacted by Codvid-19 indication was that most of their operations were already online and most of their employee were working remotely before Covid-19. However, it is also important to note that there were some Fintechs who saw their business growing greatly during the Covid-19 and this was due to an increase in purchase orders to finance Covid-19 protective gears.

FIGURE 10: HAS COVID-19 LED TO CHANGES IN BUSINESS MODELS, PRODUCT, AND SERVICES IN THE PAST TWO YEARS?



Large proportion of Fintechs slightly altered their business models, products and services due to Covid-19. This was followed by those who made no significant changes to their business model products and services, while small proportion indicated that they significantly altered their business models, products, and services. To those who significantly changed their business models, products and services, they had to move their operations from manual to online platforms and most of their staff members started working remotely. Consequently, they had to make some adjustments to their business operation policies e.g. reduction in affordability requirements when lending to applicants.

RESEARCH FINDINGS

From the study several key barriers and enablers to Alternative Finance activities were identified. Additionally, there were several risks and benefits also identified emanating from Alternative Finance activities. Table 2 and 3 below outlines some of the barriers, enabling factors, risks as well as benefits from Alternative Finance activities.

Table 2: Key Alternative Finance barriers and enabling factors

KEY BARRIERS	KEY ENABLING FACTORS
• **Lack of enabling regulations:** The absence of regulations governing Alternative Finance activities makes it difficult for consumers and SMMEs to trust the products. • **Lack of awareness from consumers and SMMEs:** The lack of financial knowledge by consumers and SMMEs as well as the lack of a recognised source of business finance advice for SMEs, hamper the use of Alternative Finance options. • **Absence of trust from both consumers and SMMEs in unconventional financial products.** • **High cost of borrowing regarding some Alternative Finance instruments;** For example, some of these Alternative Finance products are highly priced and there seems to be no co-relation between the risk and pricing of the product. • **Lack of innovative products:** Pool of products to choose from is still limited in SA.	• **Enabling regulatory framework:** This will include well developed regulatory and supervisory environment • **Enabling measures from government:** This will include programmes aimed at growing the SMMEs funding sources. • **Conductive ecosystem:** For example, well developed financial markets, financial literacy, growth in Fintechs and others. • **Incubation and Acceleration:** The Sandbox as a facility to take a closer look at Fintechs offering Alternative Finance products should be leveraged in order to encourage innovation in new products and services, understand risks (and benefits) in the markets as well as inform how we supervise and regulate this activity. • **Development of open application programme interfaces (APIs):** Open APIs enable third party developers to leverage on the database of financial institutions to deliver faster, cheaper and customised solutions.

Table 3: Alternative Finance benefits and risks

PARTICIPANT	BENEFITS	RISK
CONSUMERS	• **Financial inclusion:** Fintechs are reaching out to consumers who were previously excluded by incumbents FSPs. • **Increase in consumer choices:** Consumers are getting exposed to variety of financing products and services. • **Financial literacy:** Consumers are getting exposed to new financial products, services and ways of doing things.	• **Exposure to poor value products:** There is a lack of information regarding the pricing of some of these products. • **Data protection:** Consumer personal information on the platforms can be compromised. • **Money Laundering:** Alternative finance platforms can be used as a vehicle to launder money. • **High cost of borrowing:** Some of Alternative Finance offerings are highly priced. • **Lack of consumer education:** Consumers are not informed on the risks and benefits emanating from these products. • **Fraud:** Lack of proper due diligence on issuers of Alternative Finance products, lack of consumer education about the products and absence of regulations leaving consumers vulnerable.
SMMEs	• **Financial inclusion:** Fintechs have found profitable ways to serve SMMEs who were previously excluded. • **Growth:** SMMEs are accessing needed finances to drive growth. • **Competition in the financial services:** Alternative Finance offerings challenges incumbents FSPs offerings. • **Financial literacy:** SMMEs are getting exposed to new financial products, services, and way of doing things.	• **Exposure to poor value products:** Lack of information regarding pricing of some of the products . • **Data protection:** SMMEs data on the platforms can be compromised. • **Fundraiser over indebtedness.** • **Money Laundering:** Alternative Finance platform can be used as a vehicle to launder money. • **High cost of borrowing:** Some of Alternative Finance offerings are highly priced. • **Cyber security risk:** Platforms are susceptible to cyber-attacks.

CONSIDERATIONS

The findings from the study confirm the need for Alternative Finance mechanisms and sources for SMMEs and consumers. Furthermore, the findings also highlight the need to mitigate the risks emanating from Alternative Finance activities. It is also clear that traditional finance will not significantly reduce the SMMEs and consumers finance gap. Therefore, this calls for a longer-term intervention to remove constraints and to make finance more accessible to SMMEs and consumers.

In this regard, the following considerations aimed at promoting Alternative Finance activities and mitigating the risks they pose to the financial sector are being proposed to Financial Regulators for reflection:

CONSIDERATION 1: LACK OF ENABLING REGULATION

Establish bespoke regulations governing all forms of Alternative Finance available to MSMEs and consumers. All providers of alternative mechanisms should be covered by market conduct regulations, with appropriate oversight to ensure compliance with the regulations.

Regulations should ideally require the licencing of all participants in the Alternative Finance environment and detail the licencing requirements, describe the roles and services that such participants may provide and deal with responsible and fair market conduct, both to investors and users.

CONSIDERATION 2: LACK OF AWARENESS

Outreach and market engagement: Intensifying public engagement and education initiatives to raise awareness among SMEs on available alternative financing avenues.

The communication should address the issue of the possible lack of trust in Alternative Finance providers. Information such as all Alternative Finance providers should at least be licenced and subjected to some regulatory oversight, this should be communicated to improve trust in the use of the Alternative Finance systems.

CONSIDERATION 3: LACK OF INNOVATIVE PRODUCTS

Promoting the development of open application programme interfaces (APIs).

Enable third party developers to leverage on the database of financial institutions to deliver faster, cheaper, and customised solutions.

This will need to be supported by common standards for data sharing by financial institutions as well as requirements on information security, data exchange and other data-related policies.

CONSIDERATION 4: DATA & CYBER SECURITY

Minimise the risks associated with data and cyber security by ensuring data protection and privacy rights through appropriate legal frameworks.

Ensure compliance with data privacy regulations among those offering Alternative Finance mechanisms that guarantee that there are appropriate rules for the use, security, and control of MSMEs' and consumers data, e.g., POPIA.

CONSIDERATION 5: OTHER RISKS (I.E. MARKET, OPERATIONAL AND MARKET CONDUCT)

Encourage the use of Regulatory Sandbox to understand the benefits vs risks of the products.

The Sandbox as a facility to take a closer look at Fintechs offering Alternative Finance products should be leveraged in order to encourage innovation in new products and services, understand risks (and benefits) in the markets as well as inform how we supervise and regulate this activity.

CONSIDERATION 6: MONEY LAUNDERING & FRAUD

All Institutions participating in Alternative Finance mechanism to register as an accountable and reporting institutions under the Financial Intelligence Centre Act.

All SMMEs and consumers to report to the Financial Intelligence Centre on any transaction they are aware of that appears to be suspicious or unusual.

CONCLUSION

It is apparent from this study and studies done across the globe that Alternative Finance is a force for good. Given the benefits which Alternative Finance can bring such as access to finance, financial inclusion, competition in financial services, job creation and economic growth, there is a need for financial regulators to make the necessary changes to ensure that Alternative Finance is more accessible. A significant and coordinated effort is therefore required among external stakeholders to spur and support the development of enabling factors for Alternative Finance and, in turn, bring about the advantages conferred by the sector. With the proposed considerations, we believe it will be possible to address the risks stemming from alternative financing activities and spark its growth in South Africa.

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