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Suanne Russell
Small Business Ombudsman
Australian Financial Complaints Authority

29 September 2023

By email: consultation@afca.org.au

Dear Ms Russell

AFCA'S DRAFT APPROACH TO APPROPRIATE LENDING TO SMALL BUSINESS

As the peak body representing the mortgage and finance broking industry, the Mortgage & Finance Association of Australia (**MFAA**) welcomes the opportunity to respond to AFCA's consultation on its draft Approach to Appropriate Lending to Small Business (**the Approach**).

The MFAA is Australia's leading professional association for the mortgage and finance broking industry, with over 14,500 members. Our members include mortgage and finance brokers, aggregators, lenders, mortgage managers, mortgage insurers and other suppliers to the mortgage and finance broking industry. The MFAA's role, as an industry association, is to provide leadership and to represent its members' views. We do this through engagement with governments, financial regulators and other key stakeholders on issues that are important to our members and their customers. This includes advocating for balanced legislation, policy and regulation and encouraging policies that drive competition and improve access to credit products and credit assistance for all Australians.

There are more than 19,000 brokers in Australia, the majority of which are small broking businesses. Brokers play an important part in intermediated lending, facilitating two thirds of all new residential home loans.

Our industry research also shows that mortgage brokers are increasingly diversifying their businesses into commercial lending, largely in small and medium enterprise (SME) business lending. In the six months to September 2022, over 6,000 mortgage brokers also facilitated a small business loan. This represents 31.8% of the total population of mortgage brokers, an increase of over 10% compared to 2018, when 21.2% of mortgage brokers also operated in the commercial lending space.[1]

Importantly for this submission, brokers facilitate at least four in ten small business loans in Australia.[2] This signifies that brokers are instrumental in supporting business owners to obtain credit to both establish new business and to grow their existing businesses.

[1] MFAA Industry Intelligence Service Report 15th Edition 1 April 2022 – 30 September 2022 pgs 25 and 43.

[2] MFAA | Mortgage broker market share reaches new December quarter record

OUR SUBMISSION

As we have recognised in previous submissions, the MFAA has a collaborative and constructive relationship with AFCA, sharing data and information to build awareness of systemic and emerging issues in relation to complaints for the betterment of the system for our respective members and for their customers.

Given AFCA's key role in dispute resolution, its approach to small business lending complaints can have significant impacts to the small business lending sector, to the flow of credit to small businesses and, therefore, the whole economy.

As the Productivity Commission recognised, lending to small businesses is intentionally less regulated compared to consumer lending to avoid imposing onerous barriers to finance and impeding access to liquidity for small businesses, which may come at a significant cost — for example, the loss of business opportunities.[3]

It is therefore significantly important that the Approach strikes a balance between providing both complainants and financial firms with clarity as to AFCA's approach to complaints made by small businesses and ensuring that the Approach does not have the unintended consequence of acting as 'quasi-regulation' thereby restricting or stemming the flow of credit to small businesses.

To that end, the Approach needs to ensure that it does not go above and beyond the law or respective industry codes to establish complex and rigid approaches to small business lending.

As such, we believe there is opportunity for AFCA to refine and calibrate its draft Approach to reflect intended regulatory policy settings and to ensure it is fit for purpose. To support AFCA's evolution of its draft Approach, we provide some commentary below to help inform AFCA's understanding of the small business credit sector as well as six key recommendations.

How brokers and lenders work together to help small businesses to grow and thrive

By way of background, we thought it would be helpful to AFCA if we set out the way in which brokers and lenders work together to support lending to small business customers.

When we refer to the terms 'commercial lender' or 'finance broker' we are referring to lenders and brokers that facilitate lending to small businesses across a range of products from equipment and asset finance to small business loans.

As we noted above, brokers (both mortgage brokers and finance brokers) are systemically important to the Australian economy. It is widely accepted that brokers are critical in driving choice and competition in the Australian lending landscape. This has resulted in improvements in product features, price, customer experience and innovation for the benefit of small business borrowers. For smaller lenders, online small business lenders and new-to-market lenders without extensive branch networks or branches at all, brokers provide a critical distribution channel, and equally brokers provide access for small business customers to these lenders.

Finance brokers support their small business customers to identify lenders that offer products to meet their needs and will then work with the lender to provide solutions for that customer.

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[3] See the Productivity Commission's Small Business Access to Finance Research paper pg 34

The types of business loans that finance brokers source for their customers are wide-ranging and includes equipment finance, invoice financing, insurance premium financing or a general business loan to fund business acquisitions, start-up costs, capital investments, property acquisition or development. Business loans can be secured (i.e., by way of security on plant, equipment, property, fixed or floating charges across the business) or unsecured.

As AFCA can appreciate, small business lending is complex and extremely diverse, and in many instances requires a bespoke and individualised approach for the small business customer. Because commercial loans are more individualised than consumer lending products, brokers facilitating commercial loans will work closely with specialised credit teams within the lender, and in particular, will be reliant on the knowledge and support of lenders' business relationship teams and credit specialists.

In this way brokers and lenders work together to provide loans to small businesses that meet the requirements of that small business.

In this context we make the following recommendations.

RECOMMENDATIONS

RECOMMENDATION 1: THE APPROACH MUST STRIKE AN APPROPRIATE BALANCE AND MUST BE FLEXIBLE

While we welcome the draft Approach, we strongly recommend that the Approach needs to strike an appropriate balance between guiding industry participants with respect to lending to small businesses while also recognising that small business lending is fundamentally different to consumer lending.

There are several factors that make small business lending different to consumer lending.

Firstly, the nature of the borrower, loan and collateral is very different. Consumer lending involves individuals who borrow for personal reasons like buying a house, car, or paying for education. Small business lending caters to entrepreneurs and business owners who require funds to start or expand their businesses, with loan amounts and terms that can differ significantly. Small business loans often require collateral, or no collateral but instead with personal guarantees as security. This requirement is less common in consumer lending, where lenders rely on the borrower's creditworthiness, income, liabilities and expenses (and for a home loan, is secured by a mortgage over property).

Secondly, the risk profile of small businesses is typically far more complex compared to consumers. Therefore both lenders and brokers will consider the size, industry, business plan, financial stability, and credit history of the business when assessing the loan application. Lenders will also have differing credit risk appetites based on the industries, business sizes and risk profiles of the small business customer. As such, lenders will have significantly diverse products and pricing for small business customers that is dependent on their needs and on their risk profiles.

An overly rigid and conservative Approach to small business lending complaints may result in unintended and negative consequences, including:

- The Approach having the impact of operating as quasi-regulation on lending that is not regulated in the same way as consumer credit, resulting in lenders either no longer lending or looking to significantly change their credit risk appetite and associated lending processes.
- Adding greater complexity to lending to small businesses that will increase the cost of credit.
- Constraining the availability of capital that is crucial for small businesses to survive and thrive in a competitive market. Applying a rigid or "one size fits all" approach in relation to how commercial lenders and finance brokers should operate in lending risks making it more difficult

for small businesses to access funding, thereby hindering their ability to grow, create jobs, and contribute to the economy.

- With the availability of (in particular) unsecured credit continuing to be challenging for small businesses, it is important that the Approach does not unintentionally stem the flow of credit to small businesses.[4]
- Detering financial firms who do not have a regulatory imperative to be members of AFCA to exit the system to the detriment of small businesses.

Lastly it is also important that the Approach addresses that there is a wide range of lending products to small businesses and the types of information that the lender (and broker) will obtain from the business will vary depending on the nature of the small business lending product. For example, there will be very little reason for a lender to obtain significant financial information about a business for a loan to fund the purchase of an asset where the loan is secured by that asset.

RECOMMENDATION 2: INCLUDE BROKERS IN THE APPROACH AS WELL AS WHERE AFCA WILL LOOK TO JOIN BROKERS TO A COMPLAINT

We note that on page 40 of the Approach, AFCA states that it may join other parties (including brokers) to a complaint where that party has contributed to the loss.

While complaints related to broker facilitated small business loans are low, in our view, it is important for the broking industry to understand how AFCA would approach a broker complaint, particularly where there is a joinder between the broker and small business lender, or where the small business lender is not an AFCA member and so the complaint is instead made against the broker.

It is also important for AFCA to recognise that not all small business lenders are AFCA members. Therefore, with respect to complaints where the broker is an AFCA member, but the lender is not, it is not appropriate for AFCA to allow such a complaint to proceed simply because the only avenue for AFCA to facilitate the complaint is against the broker.

It would be helpful for brokers to understand in what circumstances AFCA would look to join a broker to a complaint, and how AFCA would deal with complaints involving multiple parties. We note that it is also not appropriate for AFCA to join a party to a complaint if the complainant does not wish for that party to be joined. We have been told by our members that they have been joined to such complaints despite the complainant stating that they only have an issue with the conduct of the lender, and not of the broker, but the broker has been joined regardless.

On this point, it is important to note also that the majority of our members are small businesses themselves. This is important for AFCA to recognise as part of its fairness mandate when there is a complaint against a small business. Our members note that resolving complaints through AFCA can be a time-consuming process with delays in collecting and reviewing relevant information and reaching a resolution. This can result in a prolonged period of uncertainty for our small business members which potentially impacts their operations and resourcing as they look to attempt to respond to AFCA requests for information. Further, the risk of being subject to an AFCA complaint without merit may also have an impact on the small business's professional indemnity policies, which are becoming harder for our members to obtain and maintain due to rising costs.

Lastly, while the MFAA appreciates the use of examples throughout the Approach document, we are concerned that there are no examples in relation to small business lending complaints made against brokers or against lenders and brokers. Such examples would be of great use to our industry. On this point, we consider that there is an opportunity here for an MFAA facilitated roundtable between

[4] See the Productivity Commission's Small Business Access to Finance Research paper pg 2

AFCA and our members to discuss examples of complaints received in relation to small business loans that would be helpful for the guidance.

RECOMMENDATION 3: NO COMPENSATION FOR FRAUD OR FAULT

Our strong view, as we articulated in our submission to AFCA's draft Approach to Responsible Lending is that there should be no compensation awarded where the complainant's conduct through the lending process has been less than transparent and open.

In fact, we believe that where the complainant has engaged in fraud or where the complainant has deliberately withheld information pertinent to the loan assessment, AFCA's approach should be to refuse to award any compensation and close the complaint. We consider that to award compensation in these circumstances would be counter-intuitive to AFCA's fairness mandate and may unintentionally incentivise dishonest behaviour.

RECOMMENDATION 4: CONSIDER THE BROADER ECONOMIC ENVIRONMENT AT THE TIME OF LENDING IN ASSESSING THE COMPLAINT

When assessing an appropriate lending complaint, it is critical that AFCA considers the context and the environment in which the credit is provided. Australia has been through unprecedented social and economic conditions where lenders were focused very much on supporting their small business customers to continue to survive and thrive.

While cognisant that AFCA will look at the information that was available to assist with credit applications, we note that with many businesses mothballed during the pandemic, there is an absence of accounting and financial information during that time. Many small business lenders tell us that they had to 'look through' this period of time, with many extending lines of credit to businesses to support their re-invigoration post-pandemic. It is important here to note also that through the *National Consumer Credit Protection Amendment (Small Business Exemption No. 2) Regulations 2021*, the Federal Government brought in an exemption from responsible lending obligations for credit that was provided *partly* for business purposes and that was aimed at facilitating the flow of credit to small businesses during the pandemic.[5] We note this exemption continues today.

In line with our submission to the Responsible Lending Approach, we encourage AFCA to consider complaints relating to small business lending in the context of the broader economic environment during which the lending was made.

RECOMMENDATION 5: RECOGNISE THE IMPORTANCE OF VOLUNTARY MEMBERSHIP OF AFCA

The Approach notes that "*not all financial firms that provide credit to small businesses are AFCA members. Examples of non-members may include asset leasing businesses and online and private equity lenders where credit is only provided to business customers*."[6]

We believe that there are benefits to AFCA membership for financial firms (even where there is no regulatory imperative). These include:

- That their small business customers have access to a fair and independent dispute resolution framework, with a free and accessible avenue for these customers to raise complaints through AFCA.

[5] See more information here.

[6] See page 9 of the Approach.

- It provides protection for small business customers from unfair and predatory lending practices, such as excessive fees, misleading information, or unconscionable conduct.
- It provides guidance and support for their small business customers throughout the complaint resolution process which can help level the playing field and ensure that small businesses have the necessary resources to address disputes they may have with financial firms.
- By holding financial firms accountable in instances of unfair or unconscionable lending, AFCA can deter such lending practices and contribute to a fairer lending environment for small businesses.
- Finally, by addressing occurrences of systemic issues, AFCA can help foster positive changes in the lending landscape for small business customers.

Recognising these benefits, we note all members of the MFAA who provide credit and credit assistance (whether lenders or brokers) are members of AFCA irrespective of whether they are required by legislation to be members of an EDR scheme or not.[7] Therefore, while not a mandatory regulatory requirement, many finance brokers and commercial lenders are already members of AFCA. This means that, contrary to the examples set out in the Approach (on page 9), many asset leasing and online small business lenders are members of AFCA.

As such, we strongly suggest that it is important for the Approach to recognise that many financial firms (be it finance brokers or commercial lenders) are members of AFCA because of the benefits that they see for their customers in ensuring the ability to access an independent and efficient dispute resolution scheme.

RECOMMENDATION 6: AFCA ESTABLISH A REGULAR FORUM WITH INDUSTRY REPRESENTATIVES IN RELATION TO IMPLEMENTATION OF ITS APPROACH DOCUMENTS

We agree that AFCA's Approaches cannot, and should not, be prescriptive in terms of how AFCA will assess complaints, whether these are responsible lending, small business lending or other types of complaints. Each complaint will come with its own set of facts and circumstances, and AFCA will therefore need to be reasonably flexible as to its approach to complaints.

Accordingly, the practical application of each Approach relies significantly on the interpretation of that Approach by AFCA case managers. For this reason, we suggest that it is important for AFCA to obtain regular feedback on how its Approaches are being applied in practice. To that end, we recommend AFCA establish a regular forum for industry representatives to discuss how the Approach is being applied in practice and to identify whether any changes are required to the Approach or other action is necessary.

AFCA's Operational Guidelines to its Rules specifically notes that it has formal and informal review mechanisms to allow for industry bodies to raise concerns with AFCA's approach. The establishment of this proposed forum would be an appropriate mechanism by which to give effect to this guideline.

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[7] See s 6.3(a)(vii) of the MFAA Constitution.

CLOSING REMARKS

We extend our thanks to AFCA for the opportunity to provide this submission. If you wish to discuss this submission or require further information, please contact me at [redacted] or Naveen Ahluwalia on [redacted].

Yours sincerely,

Anja Pannek
Chief Executive Officer
Mortgage & Finance Association of Australia

Attachment A – Responses to AFCA Questions

No	Question	MFAA Response
1	Do you have any comments about our proposed approach to assess whether a small business loan is appropriate?	Yes, we do. In addition to the above, we raise several questions and comments about AFCA's Approach document: • We query whether a lender should be required to assess the impact of future competition (see example on page 23). In this example, we question what information the lender should have further requested, how the lender would have made such an assessment and whether AFCA is suggesting that in every scenario where there may be a competing business within close proximity, that this would be enough to deny an application for a loan? • Should a lender be required to assess the proposed borrower's prior experience in managing a particular business in every situation (as noted on page 19)? In our view, entrepreneurialism should be supported, and while our members do look at experience as a factor, we have concerns that this requirement is overly prescriptive and may mean that many entrepreneurs will be denied credit resulting in businesses not being established because lenders have taken overly conservative approaches to the proposed borrower's level of competency in running a business. • Should a lender be considering prospect of success, and be declining a loan based on a consideration of the prospect of success? Lenders are not business advisors and while some degree of caution should be taken by lenders, they should not be required to analyse the potential success of a business – that is not their role. • We do not agree that AFCA should be able to re-litigate a complaint that has already been through another forum (for example farm debt mediation as noted on page 9). This is unfair for the financial firm who may have already expended significant resources and effort to deal with the complaint in that different forum. It also will incentivise forum shopping for complainants. • In terms of the example on page 17 in relation to where AFCA would consider a loan not to be fit for purpose, it notes that the lender effectively should not "*[p]rovide a credit facility with a monthly repayment schedule to a business with seasonal income, such as a farmer*". To state that a business with seasonal income should not take out a loan with regular repayments is overly simplistic. We assume that the product that AFCA is alluding to in this example is one for an agri-business to help with cashflow due to seasonal income. There may be some types of loans for agri-businesses that do require a regular repayment schedule – and this may be entirely suitable

		for the business. These types of loans are usually only entered into after a thorough business assessment, and after understanding the needs of the business. It is too broad to state that a business with seasonal income should not be put in a product with regular repayments as a business may properly provision for such repayments despite seasonality of income. • In relation to buffers (on page 21), we reiterate the comments that we made in our submission to AFCA's Responsible Lending Approach. AFCA should not be taking a blanket approach to buffers and should understand the reasons for why lenders may or may not apply buffers. The basis for APRA's requirement to apply a buffer is to ensure the stability and resilience of authorised deposit-taking institutions (ADIs) and therefore protect the interests of depositors (and the broader economy) and therefore appropriately only apply to ADIs. Those APRA requirements do not apply – and should not be applied – to non-ADIs. ADIs become subject to the obligations because of their deposit taking activities; where those activities give the entity access to cheaper funding sources than what is generally available to non-ADIs. That is, the additional obligations and costs that are associated with meeting the APRA requirements are offset by the ability to obtain cheaper funding by taking deposits. To apply the APRA obligations to non-ADIs impacts the non-ADIs' ability to compete. There is no regulatory requirement whatsoever for a non-ADI to apply a buffer and therefore we would suggest that AFCA's points made on page 21, while referring to banks, needs to also address that not all lenders are required to apply buffers.
2	Do you have any comments about the non-exhaustive list of factors on page 19 that we may consider were appropriate for a financial firm to obtain or consider during their lending assessment?	In addition to the comments we make in Recommendations 1 and 4 above, we note that certain information about a small business will not always be easily or readily ascertainable. For example, many accountants will no longer issue accountants letters or give an indication of projected income. What this means is that it will be harder to verify future projections and obtain from accountants' opinions and assessments as to whether business customers will be able to meet loan repayments. In particular, for a new business, there will not be a history of earnings. We also note that small business lending is not formulaic, and that small business lenders and brokers make their lending decisions based on subjective factors, many of which cannot be (and should not be) captured in a list of factors to consider when lending. Therefore, AFCA case managers should be wary of using the non-exhaustive list of factors as a 'tick a box' approach.

3	Do you have any comments about the list of common warning signs on page 24 that AFCA may consider should prompt a financial firm to make further inquiries during the credit assessment process?	While the list is comprehensive and it is useful to understand the range of things that AFCA may consider, we feel it lacks detail in how AFCA would apply warning signs to specific/individual complaints. Further examples would be useful.
4	Do you have any comment about our proposed approach to calculating loss and determining fair outcomes?	We would recommend a flexible approach based on the circumstances. We understand from the Approach that AFCA still could award compensation to a complainant even if the complainant's conduct during the application process contributed to the loss for example if the complainant provided false or misleading information (page 32). As noted above, we believe that there should be no compensation awarded where the complainant's conduct through the lending process has been less than transparent. We believe that where the complainant has engaged in fraud or where the complainant has deliberately withheld information pertinent to the loan assessment, AFCA's approach should be to refuse to award any compensation and close the complaint. We consider that to award compensation in these circumstances would be counter-intuitive to AFCA's fairness mandate and may unintentionally incentivise dishonest behaviour.
5	Do you have any comments about the examples provided in the Approach? Are there other examples you would like to see in the Approach?	We recommend more examples are included. We ~~would~~ recommend here that there is an opportunity for an MFAA facilitated roundtable between AFCA and our members to discuss examples of complaints received in relation to small business loans that would be helpful for the guidance.
6	Do you have any comments about our use of the phrase "appropriate lending" as a description of the standard to be applied for small business lending? This phrase is not widely used outside AFCA, but we wanted to find and use a phrase to describe	We have no comment. To us appropriate lending is fine.

	small business lending that was different to “responsible lending” (which applies to loans to consumers) and “unregulated lending” (because small business lending does have regulations).	
7	Do you have any other feedback about changes that could be made to the draft Approach to better achieve our objectives?	Yes. The recommendations that we make are noted above.