



Submission to AFCA
Approach to Appropriate Lending to Small Business

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About the Small Business Debt Helpline

The Small Business Debt Helpline (the Helpline) is a national service providing financial counselling support to small businesses. Originally established as the Small Business Bushfire Financial Counselling Support Line in March 2020, the Helpline supports any small business owner experiencing financial difficulty. Their businesses may have been affected by disasters such as fires, floods, COVID or economic factors affecting supply chains and consumer behaviour. Small business owners can also be impacted by factors closer to home such as relationship breakdowns or personal illness and accidents.

The Helpline provides assistance to small businesses with 100 or fewer employees, consistent with the AFCA definition of a small business. Our experience, however, is that more than 90% of callers operate microbusinesses of 5 employees or fewer and 55% have no employees. The most common small business structures are companies and sole traders, but the Helpline also assists partnerships, trusts and associations.

In addition to supporting small business owners directly, the Helpline provides training and information to other financial counselling agencies and secondary consultations to generalist financial counsellors all over Australia whose clients operate a small business.

The Helpline is managed by Financial Counselling Australia, the peak body for financial counsellors in Australia.

About Financial Counselling

Financial counsellors provide support, information and advice to people experiencing financial difficulty. Working in community organisations, their services are free, independent and confidential. Specialist small business financial counsellors have specific knowledge about issues affecting small businesses experiencing financial hardship.

About this submission

Since inception to 31 August 2023 the Helpline has provided 6,167 cases of assistance to small businesses. The most common reason people contact the Helpline is they are seeking help with managing their debts. Other reasons include disputes, access to grants/loans and concerns about business viability. The Helpline commonly hears from small businesses struggling to service business loans, equipment loans or leases, commercial or retail leases and ATO debts.

On the Helpline we hear from many small business operators facing vulnerable circumstances such as: mental health issues or a level of high distress. Callers are affected by family violence, addictions, a low level of financial/business literacy or are experiencing other difficulties that make them vulnerable.

The issues and challenges faced by our clients have informed our submission.

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1 GENERAL COMMENT ON AFCA APPROACH TO APPROPRIATE LENDING TO SMALL BUSINESS DOCUMENT

Financial Counselling Australia and the Helpline welcome the consultation and the documentation of AFCA's Approach to Appropriate Lending to Small Business (the Approach). A documented approach will provide valuable guidance to all stakeholders including financial counsellors working with small business clients. When credit is causing a client hardship, one of the considerations financial counsellors may have is whether or not the credit complies with relevant codes and legislation. In releasing the Approach and outlining how AFCA will assess appropriate lending, it supports financial counsellors to understand how a complaint may be handled by AFCA. In turn, this will assist financial counsellors in providing prompt and accurate advice to clients about their options.

The document is clear, easy to read and the inclusion of examples in different sections provides valuable guidance on AFCA's application of the Approach. We consider section 4 'How we determine fair outcomes and calculate loss' to be of particular assistance when advising clients and managing expectations of what AFCA may consider to be a fair outcome.

We consider the document could be strengthened by more explicit acknowledgement of its applicability to the broad range of small businesses, recognition of small business borrowers experiencing vulnerable circumstances, and any interaction with other AFCA approach documents where appropriate.

2 VULNERABLE CIRCUMSTANCES

The document as currently drafted does not provide guidance on AFCA's approach in circumstances where the borrower is experiencing vulnerable circumstances. Section 3.5 'Considering if the credit assessment was appropriate' is the only section to acknowledge a person may be vulnerable and it is limited to the context of a co-borrower or guarantor. The need to consider if a guarantor may have vulnerabilities is appropriate including in cases where the borrower is a company and director guarantees are provided. However, this consideration should also be applied to the borrowers themselves, where the borrower is a natural person.

In the Helpline's experience it is important to recognise that small businesses are run by people and accordingly they can experience vulnerable circumstances similar to those of individual consumers, particularly in the case of micro businesses. Callers are impacted by diagnosed mental health illnesses, high levels of distress, and low levels of financial/business literacy. A proportion of callers face language and cultural barriers. Furthermore, there are situational considerations which may make a borrower vulnerable such as desperation.

Concerningly, we have a portion of callers experiencing domestic violence. In these instances, the person may have been coerced into directorships, loans and guarantees without any ability to influence the business/company activities or access the items purchased/funds borrowed. In some situations, they have not had any knowledge of the loans or their directorship until an issue has arisen.

We acknowledge the existing AFCA Approaches ‘Financial Elder Abuse’ and ‘Joint Accounts and Family Violence’ however they are currently drafted to provide guidance in relation to consumer and personal credit. It is unclear if AFCA would apply the concepts in them when assessing the relevant factors of appropriate business lending.

Vulnerable circumstances of small businesses between over time (n = 2738)

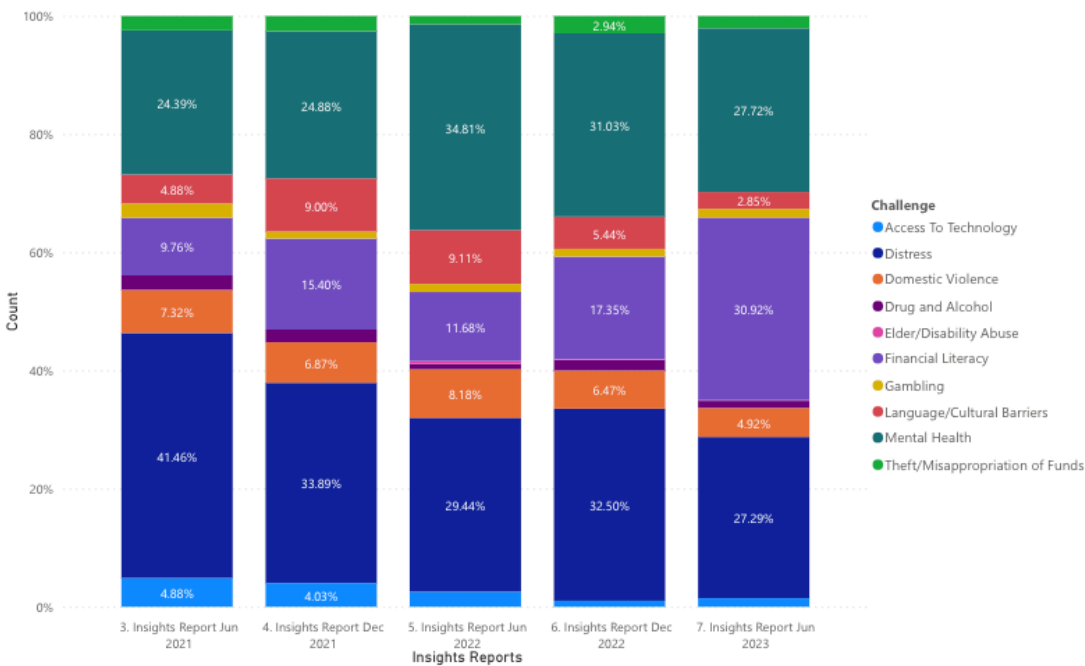


Figure 1: Vulnerable circumstances of small businesses contacting the Helpline (six month periods, inception to 30 June 2023)

Recommendation

The Approach to Appropriate Small Business Lending be expanded to recognise small business borrowers may be vulnerable.

- the relevant factors or information listed on page 19 & 20 include ‘if the credit facilities involve a borrower where that person is vulnerable in some way’,
- provide guidance on relevant considerations in such circumstances,
- reference applicability of any existing AFCA Approaches, and
- incorporate examples of borrower vulnerability and AFCA decisions in relation to appropriateness of lending and determination of fair outcomes and calculated loss.

3 BUSINESS PURPOSE

We support in general the guidance regarding when a business purpose declaration is effective and the positive obligation it places on a credit provider to make reasonable inquiries about the purpose of credit. In our experience small business operators can have co-mingled personal and business finances and don't necessarily understand the implication of declaring a loan is for business purposes, or indeed what constitutes a business purpose.

When completing a credit application, ticking a box 'for business purposes' is not sufficient to absolve a lender from assessing the existence of genuine business operations or making enquiries about how the funds will be applied. The Approach appropriately outlines AFCA may consider the statutory warranty, where it applies, that the financial services provided be reasonably fit for the purpose or desired result that the small business makes know to the financial firm, expressly or by implication (ASIC Act s 12ED (2)). To know the purpose of credit applied for by a small business requires a level of enquiry and seeking of information by the financial firm beyond a tick box that the credit is for a business purpose.

Similarly, we do not consider the existence of an ABN to be sufficient evidence on its own of the existence of an active business. At a minimum the ABN must be active indicating that a business may be trading. For newly acquired ABNs additional enquiries are warranted to ascertain if a genuine business and business purpose exists.

The draft Approach appropriately references the "business purpose" test in the credit laws. The current test, as amended in 2020, is that lending that is genuinely for the purpose of a small business, as long as that purpose is not merely minor or incidental, is exempt from responsible lending obligations (RLOs). This exemption is slated to expire in October 2024. If that happens, then the previous business purpose test – that only lending that was "wholly or predominantly" for business purposes would be exempted from the RLOs. We assume that AFCA would amend the Approach document if this happened. (For the sake of completeness, we note that we have been consulted by Treasury about the exemption and have argued that the previous wording should be restored.)

Recommendation

The Approach include guidance as to what would be considered 'reasonable inquiries for the purpose of which the credit was provided'. Including inquiries required to ascertain existence of a bona fide business part of which requires minimum checks on provided ABNs and considerations of the resulting information.

4 CREDIT ASSESSMENT FOR SMALL AMOUNTS

When considering a financial firm's assessment process the Approach references AFCA giving consideration to the:

- type of financial firm,
- type of credit product, and
- characteristics of the borrower.

In the experience of the Helpline, it is common to see micro business that have initially applied for relatively small amounts of credit however the terms of the credit arrangements are such that the amount has escalated to a comparatively large debt relative to the size of the business and the original debt. We see this occurring through:

- high base interest rates, including rates in the order of 27% pa and higher
- exorbitant penalties and additional interest in the event of missed repayments, combined with repayments required on a daily or weekly basis
- provision of additional credit rather than hardship arrangements

Typically the loans are unsecured and if the borrower is a company the director(s) have provided personal guarantees. The effect is whilst the credit may have been for a business purpose, personal assets including the family home are at risk. In such circumstances consideration of the credit provided being reasonably fit for the purpose or desired result of the small business and likely capacity to repay are particularly important considerations when assessing the appropriateness of any credit provided. Accordingly we consider the factors listed on pages 19 and 20 and the circumstances listed on pages 24, 25 and 26 are relevant considerations irrespective of the amount of credit provided.

5 TERM 'APPROPRIATE LENDING'

The term 'appropriate lending' clearly conveys the nature of the standard to be applied whilst differentiating it from the requirements of 'responsible lending'.