Banking Code Review 2021

Commercial & Asset Finance Brokers Association of Australia

2021

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Mr Mike Callaghan
Code Reviewer
2021 Code Review
Australian banking Association
c/- PO Box H218
Australia Square NSW 1215
Email To: submissions@bankingcodereview.com.au

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2021 Independent Review of Banking Code of Practice

Dear Mr Callaghan,

The Commercial & Asset Finance Brokers Association of Australia (CAFBA) welcomes the opportunity to provide our views to the Independent Review of the Banking Code of Practice 2021 (the Code). We have appreciated the time afforded by you to discuss our views and would like to now set these out in this submission for your consideration.

Background on CAFBA

The Commercial & Asset Finance Brokers Association of Australia (CAFBA) is the peak national body of commercial and equipment finance brokers, whose prime area of business is the distribution of commercial and equipment finance facilities to their clients. With over 1,000 members, in all states and territories, CAFBA is an important national voice in Australian finance.

CAFBA members are career professionals, with recent studies showing nearly 73% (East & Partners 2020) of new commercial equipment finance is sourced through brokers. Our members and their clients are predominantly small to medium-sized businesses and operate in the commercial finance market. The total receivables in the Australian commercial finance market are approximately $380billion, so it is an important component of the Australian economy.

CAFBA members know that providing Australian small businesses with access to finance is crucial to economic growth. Although brokers are commonly associated with home loans, CAFBA members work in a complex environment to provide a boutique service. Without the work of CAFBA's professional members, many Australian small business owners would struggle to navigate the complexities involved with commercial finance.

CAFBA embodies the strengths of its members in a unified approach for dealing with financiers and legislators at a national level and regularly seeks the views of members. As an association, CAFBA provides the framework and support to professionally assist our members in their daily activities. This involves education and training, legislative and regulatory updates, and forums where the members can interact and exchange ideas with their peers.

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CAFBA prides itself on being self-regulating and maintains strict membership standards on probity, continuing professional development, minimum education standards, industry experience, and reputation. It is a condition of CAFBA membership that commercial finance brokers must belong to the Australian Financial Complaints Authority (AFCA).

CAFBA is a member of the Council for Small Business Organisations of Australia (COSBOA) and works collaboratively with the government, regulators, and business groups.

The Interim Report

CAFBA would like to concentrate its comments on small business lending, and how the Code affects commercial finance brokers and lenders in how they provide services to their clients.

One of the main issues outlined in the Interim Report was whether the Code's drafting should be principle based or prescriptive.

This raises the very important distinction of who are the main beneficiaries of the Code, and whether it is customer focussed, and will the Code provide for better customer outcomes. The customers fall into two broad categories:

1. Consumers
2. Small Business

Chapter 1 of the Code sets out the parameters of the classification of a business:

What is a "business"? A customer is treated as a business if they apply for, or receive, a banking service for a purpose that is wholly or predominantly a trading or commercial purpose, and where the National Credit Code does not apply.

For some time, this distinction of a small business has not been clearly applied with consumer lending obligations being morphed into business lending. If the notion of ***What is the purpose of the loan?*** was clearly applied, then better customer outcomes would be arrived at. Once this is answered then the processes to deal with either category of customer should be clear. If the loan is for personal or lifestyle purposes, then it is a "consumer loan". If the loan is to be used to earn assessable capital gain or income, then it is a "business loan". All other considerations flow from this premise.

Applying restrictive and prescriptive criteria to a small business customer does not provide a proper understanding of the customer's business, and the type of commercial product that is required. Small business lending needs to be principle based to avoid access to finance being inhibited. Small business customer needs vary greatly, and a prescriptive approach can never quantify all situations. An over reliance on compliance and attempting to Pidgeon-hole lending will be very detrimental to the needs of small business.

Difference Between Personal and SME Lending

CAFBA believes that the difference between household and domestic use and SME lending needs to be both emphasised and understood. CAFBA upholds the right of all consumers and every business to be protected from unjust practices and to have ready access to fair remedies; however, there is a clear distinction between the needs of consumers and businesses when seeking to borrow money, and Responsible Lending laws have not assisted this distinction, and in fact caused difficulties in obtaining finance for small business, due to the unnecessary application of responsible lending laws by lenders for small business. NCCP is a prime example, gazetted to assist consumers and specifically not extended to businesses, but often applied to both.

Often this distinction can be seen in how a consumer loan is assessed compared to a business loan. A consumer loan looks backwards at history and earnings. In many respects a business loan is forward looking, with future cash flow, key contracts and other considerations being critically important.

In Australia, there are several key differences between personal finance, including mortgages, and SME finance, including business lending. It is important to understand the different prudential requirements and the rates at which businesses can secure loans.

Key points about the difference:

- While some terminology in commercial and consumer loans is similar there are fundamental differences. Both the purpose and customer profile of commercial loans is different. The assessment and outcome for the customer is also different. In particular, the ongoing relationship between the banker/broker and the business customer should be entirely different. This difference means that the way regulators examine commercial finance must be different to consumer, and hence also the lending parameters.
- Small business finance is significantly more complex than a mortgage or other consumer loans and should be assessed accordingly.
- Due to the complexity of operating a business, commercial loans are more difficult to obtain than a consumer loan e.g. a mortgage;
- Small business finance requires more ongoing attention to business progress, cashflow management, issues in the market, fluctuations in demand and consumer sentiment, and other issues.
- Loans for small businesses may need to have a more custom approach than personal finance, requiring negotiated flexibility due to the nature of the business.
- Banks can find business finance far more challenging to process, particularly when engaging with some sectors within small business,
- Assets used in small business finance can be uncommon and therefore require specialist knowledge to assess the loan purpose.

Many businesses in Australia have expressed frustration at the complexity and barriers that they face when seeking a loan. Some of this is due to lenders applying consumer lending laws to commercial loan applications, which is inappropriate and an obstacle to good credit decisioning. It is essential that we allow small businesses the opportunity to invest, to expand their businesses, to employ and create wealth, and the Code should make clear distinctions to prevent any unintended impediments to those customer objectives.

Recognising this, one of the recommendations of the Hayne Royal Commission was not to extend responsible lending laws to small business, and this tenet should be reflected in the Code.

Communication of Credit Decisioning

The Code states that a bank must provide a reason for declining a loan if it is reasonable to do so. A typical response for a decline is often "not Creditworthy", but this does not tell a small business what they need to do to be eligible for a loan, or what additional steps they could have taken to raise their "appeal" to the prospective lender. Often the loan parameters are simply not compatible with the lender's bespoke credit appetite or policies, but this is not conveyed to the borrower who could potentially be reluctant to make further applications which would otherwise be successful. Properly communication of credit reasoning will give them more realistic expectations and will assist the business to obtain finance in the future. An educated workforce will be better skilled to assess loans on their merits and take time to provide a better-informed decision. We note some submissions to the independent review suggested a time frame for credit decisions. Our view is that this would be detrimental, as each loan is different and will need differing timelines. The Bank should however be obliged to keep the customer informed of progress in a timely manner.

The role of Education

Many of the issues raised in this document can be addressed through an educated and more competent work force.

It is important that those providing commercial finance have the required skills to adequately assess a small business loan. Often the question should be not ***why did the bank provide this loan, but why didn't the bank provide this loan?***

This notion reflects the outcome from the Royal Commission where reference was often made to the change from asking 'Can we?' to 'Should we?'.

CAFBA members are required to have a minimum education standard to belong to CAFBA and assist business clients to access finance. Further in 2019 CAFBA released its Banking Code of Practice Broker Compliance Guide to assist members in their obligations to provide good customer outcomes.

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CAFBA has developed and educational pathway into commercial finance, which includes a Certificate IV and Diploma to ensure those who practice in the industry are qualified to do so. The adoption of processes to decision score loans has led to the diminishing of the fundamental skill of credit assessment in the industry, which underscores the need to have a principle-based approach to credit assessment for small business.

Summary

To better assist small business lending the Code should be principle based. A more rigid and prescriptive approach diminishes the ability to assess business with different circumstances and the ability to be empowered to make decisions.

The Code should also clearly articulate when it does and does not apply to either Consumer of Business loans. The distinction between those two loan types should be determined by the purpose of the loan.

CAFBA would also like to acknowledge and endorse the content of ASBFEO's submission to the Review.

We appreciate the opportunity to provide these comments, as the overarching goal of the commercial finance industry is to provide better access to finance for small business and to ensure this finance meets the needs of business.

Yours sincerely,

David Gandolfo
Past President and Advocacy Chair
Email: advocacychair@cafba.com.au
Mobile: 0412 571 500

Matthew Atkin
President
president@cafba.com.au
Mobile: 0402 596 996