

23 September 2016

Ms Silvia Renda
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By email: smallbusiness@fos.org.au

Dear Ms Renda

FOS Consultation on Small Business Jurisdiction

The Customer Owned Banking Association (COBA) welcomes the opportunity to comment on the Financial Ombudsman Service's (FOS) Consultation Paper *Expansion of FOS's Small Business Jurisdiction*.

COBA is the industry association for Australia's customer-owned banking institutions – mutual banks, credit unions, and building societies. Collectively, the sector we represent has \$101 billion in assets and more than 4 million customers. Most COBA member institutions use FOS for their external dispute resolution (EDR).

COBA supports EDR as an effective way to resolve customer disputes in a quick and cost effective way without the need for consumers having to go to court. However, COBA has some concerns with the proposed changes to FOS's small business jurisdiction. COBA believes that these proposals go beyond the original intent of EDR and could have unintended consequences of limiting small business lending and increasing costs for small business lending.

COBA understands that FOS's small business jurisdiction was originally created to support small businesses such as sole-traders and small operators (less than 20 employees for non-manufacturing businesses) who have limited resources and knowledge to challenge a dispute with their financial institution through the court system.

The proposed changes to expand FOS's small business jurisdiction moves away from this original intention and allows larger businesses involved in more sophisticated lending arrangements to have access to EDR. COBA is concerned that this moves away from the original intention of EDR as a mechanism for those without the means to pursue their claim through the courts.

As an example, a business with a \$10 million credit facility or a business with a \$2 million dispute is likely to be sophisticated. Given loan to value ratios, a business with a \$10 million credit facility is likely to have at least \$15 million in gross assets. A business of this size is likely to have the resources to make take legal action through the court system. COBA questions whether it is proportionate or appropriate for businesses of this size and sophistication to have access to external dispute resolution.

ASIC's own website makes the point that consumer and commercial lending should be treated differently:

*"In relation to commercial loans, the courts generally impose a high bar when a borrower (or ASIC) alleges that conduct of a lender is unconscionable. Courts interpret these laws in light of the business nature of the transaction and on the basis that **generally commercial parties can look after their own interests**. Therefore, although conduct may seem unfair, this may not necessarily amount to unconscionable conduct under the law. To successfully take action for unconscionable conduct in commercial lending, there must be some evidence that the lender has improperly taken advantage of a power imbalance between the parties."¹*

We feel that the proposed changes do not reflect the fact that consumers and commercial borrowers have a different level of sophistication and therefore should have different avenues for redress.

COBA is concerned that the proposed changes will have the unintended consequence of ADIs becoming more risk averse about small business lending, particularly for larger value credit facilities. Lenders may seek to limit small business lending or seek to build risk minimisation strategies into the process which have the potential to increase costs for small business. For example, lenders may insist on something like a "Financial Advice Certificate" from an accountant or lawyer to ensure the borrower understands the terms of the credit facility prior to entering into a credit arrangement.

In addition, COBA is concerned about the potential jurisdiction overlap between an expanded FOS and the Australian Small Business and Family Enterprise Ombudsman, which exists to²:

- Advocate for small businesses and family enterprises;
- Provide access to dispute resolution services to assist businesses to resolve disputes without resorting to costly litigation; and
- Ensure that government policies take into account the needs of small businesses and family enterprises.

COBA questions whether FOS is the right organisation to undertake the specialist area of small business disputes, particularly when the Small Business and Family Enterprise Ombudsman already exists and could deliver this service.

Other specific comments are outlined below.

COBA does not support the increase in the small business credit facility (SBCF) compensation cap from \$309,000 to \$2,000,000 because the magnitude of the increase has not been justified. COBA believes that this quantum of compensation is better left to the courts because FOS is not bound by legal precedents or legal principle.

COBA members also believe that the SBCF limit for debt related disputes and the prohibition of debt recovery proceedings should both be capped at \$5 million rather than the proposed \$10 million.

COBA does not support the proposal to amend the remedies that FOS can award to include the ability to forgive a debt or vary an unregulated credit facility. This is unacceptable for EDR as lenders do not have the ability to appeal.

The proposed change to the prohibition of debt recovery to \$10 million from \$2 million is significant and COBA does not believe this five-fold increase is justified. Instead, we suggest this should be capped at \$5 million. COBA is also concerned that this could be

¹ <http://asic.gov.au/about-asic/contact-us/how-to-complain/disputes-about-commercial-loans/>

² <http://www.asbfeo.gov.au/about>

used as a delaying tactic by unscrupulous operators in cases of insolvent trading. The changes must protect both secured and unsecured creditors of a business.

The inability for ADIs to have FOS decisions reviewed creates a level of uncertainty for ADIs. Increasing the amount of compensation that can be awarded to \$2 million exacerbates this risk. FOS, in its decision making, is not bound by legal precedents or legal principles.

COBA has no comment on proposal 3.1, which seeks to clarify the small business definition. However, one COBA member has suggested that it would be preferable if FOS included a gross assets and/or revenue test for an aggregated group, rather than relying solely on a maximum employee test. For example, for reporting and auditing purposes, the Corporations Act provides that a 'small proprietary company' is a company with two of these three characteristics:

- annual revenue of less than \$25 million;
- fewer than 50 employees at the end of the financial year; and
- consolidated gross assets of less than \$12.5 million at the end of the financial year.

COBA is concerned that there is little mention of aggregation and how tests to determine "small business" status will apply to groups of related individuals and entities. Aggregated groups generally include both commercial and consumer debt. COBA seeks further clarification on how the limits would apply in these circumstances.

COBA also seeks clarification on how the proposed funding model will operate. ADIs that have very few or no small business customers should be exempt from any funding model.

Please do not hesitate to contact Alex Thrift at athrift@coba.asn.au or (02) 8035 8447 if you wish to discuss any aspect of this submission.

Yours sincerely



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