

17 April 2018

**The Royal Commission into Misconduct
in the Banking, Superannuation and Financial Services Industry**
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Please find attached the first submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (FSRC) from COSBOA. We will provide a second submission shortly regarding our concerns with the superannuation industry.

We recommend this submission be read in conjunction with submissions from the Australian Small Business and Family Enterprise Ombudsman (ASBFEO). We also recommend that certain member organisations be considered for opinion and comment. We particularly refer you to opinion of and submissions from Commercial & Asset Finance Brokers Association of Australia (CAFBA) and Rural Business Tasmania. Both these organisations are represented on the COSBOA board.

While we have not provided case studies and examples we refer to those provided by the ASBFEO and others. We are most interested in improving the system.

We consider one of the most important issues to note when it comes to financial issues is the difference between a small business person and a personal consumer. In the past we have had difficulty in ensuring understanding of the difference and this has created problems in process, communications and legislation. We are pleased to note that the ASBFEO and the Productivity Commission have shown an understanding of this key difference.

Basically, a consumer needs financing for a home or for another purpose. They will normally have a job combined with assets to support access to finance. A small business person will need financing for their homes and other purposes as well, plus they will often need to use their assets to fund a business or their business activities. We should not apply consumer loan regulations and processes to business activities and we should acknowledge the difference in knowledge and resources between a small business and a big business. Please contact me on 04233 644 097 for further information.

Yours sincerely



Peter Strong
CEO

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Submission to The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

The general issue for COSBOA and its members is that knowledge, process and communications within the finance sector need to be streamlined and where possible automated. We know that some 80% of any dealings with small business by big business or from government is about process and communications.

A small business can be a person or a couple who have a complexity of regulators and regulations to deal with, while also running a business. A small business operator has competing priorities and does not have time or dedicated resources for the myriad of business matters such as HR, Finance, Marketing and day to day operations. They all have their own private lives with the normal issues that go with education, health and so forth. If business process is complicated and communications difficult then mistakes may be made and key messages missed at either end of finance negotiations and processes, either by the business person or by the lending organisation.

There are certain areas where poor communications, misinformed attitudes and behaviours or confusing processes can create angst and suffering for small business people. Our main issues centre on:

- communications between financial institutions and small business people;
- lenders' understanding of small businesses
- the cost of finance;
- access to finance;
- use of the right finance product, rather than defaulting to simply extending a home loan
- the background compliance demands placed on financial institutions that impact on their dealing with small business people;
- the consideration of compensation when a business is wronged;
- independent resolution or support avenues for those small business people finding themselves in financial distress
- the behaviour of the debt recovery divisions of the various banks when compared to the commercial operational areas;
- how small business people currently access finance including the use and benefits of intermediaries such as brokers;
- management of changes in interest rates; and
- the provision of better information on the above issues to help inform comment and policy.

We believe that better information will enable better decisions to be made that have long term impacts on small business people and the general economy.

These are the issues in detail:

Communications between financial institutions and small business people

Problems and a lack of trust can be created by poor communications or assumptions based around a small business person's ability to understand financial processes and contracts.

The training of bank staff in communicating with small business customers is an issue that needs to be addressed. Bank staff often don't understand small businesses or do not clearly convey why they need certain information. Business owners are often frustrated by elements of the credit process that appear to be unnecessary or intrusive.

This failure of communication is an important issue and also explains why businesses using asset finance brokers may have less problems as they have access to an expert who is trusted.

Accessing finance – cost, process, compliance

There is a real issue around how a small business person accesses finance. Currently to access a business loan requires complicated paperwork around cash flow, business plans, projected income and profits, previous tax returns and various financial statements and copies of contracts.

APRA's prudential standards can have a negative impact on bank lending to small businesses. For example, the risk weighting for unsecured commercial lending at 100% in APS 112 is too high.

The \$1 million threshold at which small business exposures are treated as corporate (instead of retail) in APS 113 is too low. This limit was set in 2008 at the time of the GFC and was below the €1 million limit in the Basel standard. For exposures above \$1 million, banks are required to hold additional capital and conduct an annual review of the borrower. This is an unnecessary requirement on the banks.

These requirements encourage bank staff to by-pass the business loan process instead suggesting the business person takes a personal loan or extend home loans for business purposes. Given that the same asset would be used as collateral, normally the family home, the streamlining of process seems sensible.

But this is not considered proper process by APRA. Given that the RBA and COSBOA believe that up to 80% of business loans are completed this way it seems that what is 'proper' process is not seen as the best process. APRA, working with banks and the small business community, needs to review these demands and regulations. Given the recommended processes are in the main ignored it seems to fail any 'fit for purpose' test.

The prevalence of this process also skews any statistical data collected on small business loan defaults. The data that shows small business are more likely to default is questionable given that the majority of loans are through other 'non-business' processes.

The background compliance demands placed on financial institutions that impact on their dealing with small business people

As mentioned above red tape and compliance are issues for small business people. It also appears to be an issue for bank workers.

Banks may be applying the rigorous compliance for consumer exposures required under NCCP to all retail exposures, including small business. This increases the compliance burden and may also be preventing bank staff from providing advice to small business applicants, since they don't want to appear to be leading the applicant when filling out any application.

The consideration of compensation when a business is wronged

There will always be mistakes, sad but true. The determination of compensation is then an issue. Currently that is determined by the financial institution and that is a process that must change. An independent organisation must be charged with determining compensation when required.

When considering compensation it is not just the financial loss that must be considered but also the hardship created for a family and the mental stress and anguish forced onto individuals.

Independent resolution or support avenues for those small business people finding themselves in financial distress

Limited support avenues are available to small business people to assist facilitate and guide when things don't go to plan. Financial counselling services are provided to consumers but are currently limited to rural small businesses. Similarly, debt mediation legislation is not consistent throughout Australia and would not be known to or utilised by a high proportion of those small business operators who face financial distress. Big business are able to access costly legal and accounting expertise to match with banking and lending institution support when dealing with negotiations that may have gone awry. A small business person with limited time and resources is not able to match this expertise when things get tough.

The behaviour of the debt recovery part of the various banks when compared to the commercial operational areas

There is a marked difference between the behaviour of different parts of financial institutions when dealing with small business. This is perhaps not surprising given one bank division may be tasked with selling a product and another with debt collection. But the change in attitude and approach can be quite devastating for a business person who is used to dealing with a fair minded and compassionate local bank employee and all of a sudden is confronted by a demanding aggressive employee from another part of the same institution.

To limit mental health and stress issues we recommend better communications or a better process of informing business people that the process will become more intense.

Information on how small business people currently access finance including the use and benefits of intermediaries such as brokers

In general, it is fair to say that bank staff involved in small business lending have a skills gap. This leads to a bank employee offering a product they understand, usually an extension of a home loan, rather than the appropriate product such as Trade Finance, Debtor Finance, Asset Finance, etc.

This problem has resulted from most banks commoditising the provision of small business finance and deskilled their credit areas. As a result, for example, applications for loans below \$150,000 often do not get properly assessed, and banks don't take the time to get to know their small business borrowers properly.

In contrast, for example, the majority of business loan brokers build a relationship with customers and use this as a selling point. Brokers will also gather financial statements and assess them even though they may not need to submit them.

The range of bank products will be understood by brokers who specialise in them whereas a bank employee will of course have greater understanding of their own product. Banks should endeavour to provide products with more flexibility that do not tie up property as collateral and give more options for a business in planning and responding to changing business conditions.

Management of changes in interest rates

We have not had a change in bank interest rates for some time. When changes do occur, which will likely be upward, we need to have much more transparency in how changes are applied to business than we have had in the past. Previously as interest rates dropped the consumer would be given the lower rate well before the small business person would be given the decrease. This was never adequately explained and created much angst. We need to ensure that small businesses are not used as a way to fund lower rates on consumer loans.

The provision of better information on the above issues to help inform comment and policy

There needs to be continual review of process and communications between the finance sector and the small business community.

Contact Peter Strong on 0433 644 097 or ceo@cosboa.org.au for further information.

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