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Dr Kathleen Dermody
Committee Secretary
Senate Economics Legislation Committee
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Dr Dermody

Inquiry into Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015

The Australian Bankers' Association (ABA) is pleased that this Bill has been referred by the Selection of Bills Committee to this Economics Legislation Committee for inquiry.

At the outset, the ABA recognises that this Bill is to implement a firm election commitment to extend unfair contract terms legislation to small business contracts. Our aim is to ensure that in achieving the policy intent of assisting those small businesses that are not always in a position to fully understand, or to seek legal advice on the terms of some standard form contracts, the Bill in doing so does not create legal uncertainty and unintended consequences for businesses generally.

There are several significant problems with the drafting of the Bill which if not addressed will create unforeseen consequences and uncertainties with respect to the intent and application of the legislation.

The ABA has worked to identify specific changes to the legislation that would address these concerns, while allowing the legislation to operate as intended.

The ABA believes this Committee inquiry process will assist in casting light on these problems and their potential resolution.

This submission commences with a short summary of four key issues with suggested amendments to the Bill for dealing with each of them.

Detailed commentary on each of the four issues is included in section 2 of this submission.

1. Summary of ABA's submissions

First, without certain amendments to the Bill, larger businesses other than those small businesses intended to be covered by the Bill will be able to take advantage of the legislation. This would significantly impact all businesses, including banks, which will be required to identify, review and amend, where necessary, their suites of standard form business contracts including those contracts employed for use in major institutional and financial markets transactions.

The range will include contractual terms for normal business lending and other banking services extending to a broad range of business facilities. These will not be confined to small business contracts. The Schedule to this submission provides a non-exclusive list of the types of relevant products and services involved.

Because banks may operate with segmented business units including institutional, corporate, agribusiness and business banking units, the documentary review process will entail reviewing multiple versions of documents for each affected business segment and at significant cost unless the this issue is addressed in the Bill.

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Submission

The Bill should be amended to provide that a "small business contract" is one in which at least one of the parties is a business having fewer than 20 employees and is a business having an annual turnover of less than $2 million (to be determined at the time the contract is entered into); and for the avoidance of doubt excludes a subsidiary or related party of a business that would not in itself be a small business, part of a corporate group that collectively would be considered not to be a small business and a special purpose of joint venture vehicle associated with a business that would not itself be a small business.

Secondly, and coupled with the first concern above, is a further uncertainty in the drafting of a "small business contract".

Businesses are able to enter into certain credit and financial services standard form contracts and to conduct transactions far above the simple amount of the consideration provided for the contract to which the monetary thresholds are intended to apply and which are described in the Bill as the "upfront price" in Item 8 clause (4) in Schedule 1 of the Bill.

Together, these uncertainties will mean that the range of standard form contracts requiring review and possible amendment by the ABA's member banks will be extraordinarily wide. Unless addressed, these will create significant legal uncertainty for all businesses including small businesses.

Submission

The "upfront price" should apply to the value of the financial product to which the financial service relates (see s761G Corporations Act 2001 and Corporations Regulations 7.1.11 – 7.1.28 for how the value is calculated as applying to various financial services products) for the purpose of the "upfront price" thresholds described in Item 8 clause (4) in Schedule 1 of the Bill.

For the avoidance of doubt any financial product or financial service provided to a sophisticated client as described in sub section 761G (7) of the Corporations Act should be excluded.

Thirdly, the Bill does not provide guidance for a court. In an application by a small business for the court to declare a standard form contractual term to be void, the ABA believes that the court should take into account the prudential implications, including systemic implications, for banks and other authorised deposit taking institutions, if the term is liable to be declared void.

Submission

The Bill should include a further subparagraph in subsection 12BG of the Australian Securities and Investments Commission Act (ASIC Act) -

"(c) the extent to which the term of a small business contract is reasonably necessary having regard to the prudential obligations and standing of an authorised deposit taking institution and the impact on the financial safety, stability and efficiency of the financial system if the contract term were to be declared to be void."

Finally, the commencement date of six months for the Bill's provisions to come into effect after the Royal Assent is manifestly inadequate for banks and should be extended to twelve months. This is because of the range of standard form contracts for business banking services that will have to be identified, then reviewed and amended as necessary, including the time and ability for scheduling these changes to be made through their IT systems.

Submission

The Bill should be amended to provide that the commencement date in Schedule 1 of the Bill is to be the day after the end of the period of 12 months beginning on the day this Act receives the Royal Assent.

If the existing uncertainties and overreach in the Bill concerning the scope, application and timing of the proposed reforms are not resolved, this will have a significant impact cost wise on those businesses such as banks which will be required to review their standard form contacts, including those small businesses which will be required to do the same.

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It will be for individual credit providers to assess whether there may be any increased credit risk in their lending to small businesses and what impact this may have on access and pricing considerations.

Further, the uncertainties, unless resolved, could lead to the prospect of speculative litigation and business costs and other risks, including for small businesses.

2. Detailed commentary

2.1 "Small business contract"

Meaning of "small business"

There are two key elements constituting the "small business contract".

The first element is that at least one of the parties to a standard form contract must be a business employing fewer than 20 employees.

One of the key objectives of the Bill is to ensure that small businesses are protected from their perceived inability to read and understand the terms of certain standard form contracts and to negotiate those contracts with the acquirer or provider of goods and services. It is said that protection for these small businesses arises because they are often time poor and inadequately resourced.

As it stands in the Bill, with a "small business contract" meaning a standard form contract with at least one of the parties being a business employing fewer than 20 employees, this would result in many businesses of substantial worth which would not normally be regarded as either time poor or inadequately resourced businesses being included in this definition.

These businesses would include substantial businesses that are well resourced and sufficiently capable of understanding and negotiating contractual terms of a supplier or as an acquirer of goods and services under standard from contracts.

The ABA has previously submitted that this employee based definition, without further limitation, will result in the inclusion of many businesses of substantial worth and sophistication that would not normally be regarded as small businesses.

The Decision Regulation Impact Statement (RIS) prepared by the Commonwealth Treasury for the legislation and assessed as compliant with the COAG RIS requirements by the Office of Best Practice Regulation (OBPR) contains a survey of a range of businesses of which 264 participated.[1]

The Commonwealth Treasury, on behalf of Consumer Affairs Australia and New Zealand (CAANZ), undertook the survey from 23 May 2014 to 1 August 2014 on business contracting practices and unfair contract terms.

The RIS states:

The majority of participants were from businesses that could be classified as 'small', with 173 (66 per cent) having an annual turnover of less than $2 million (Figure 2) and 208 (79 per cent) reporting having fewer than 20 employees.

In reporting experience of small businesses with standard form contracts the RIS states:

Standard form contracts are mainly used where the transaction value is below $100,000 and least likely to be used for transactions above $250,000.

The RIS added (see Fig 3 of the RIS) that:

Only 22 per cent of small businesses are offered standard form contracts worth more than $100,000, compared with 57 per cent of medium and large firms.

And further that:

[1] See http://ris.dpmc.gov.au/2015/06/11/extending-unfair-contract-term-protections-to-small-businesses/

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- *Participants were also asked about the value of the contracts which included unfair terms. The majority unfair terms encountered by small businesses were in contracts with values of less than $100,000. For larger businesses, 40 per cent of the contracts reported to have unfair terms were for values above $250,000. In contrast, only 12 per cent of small businesses finding unfair terms stated that these contracts had a value above $250,000.*

The ABA understands that many special purpose and joint venture vehicles would fall within the current scope of the Bill.

Further, banks have taken steps and have identified significant numbers of their business customers which fall into the substantial business category despite their having fewer than 20 employees yet would be able to take advantage of the Bill's provisions.

We are confident that this is not the Government's intention.

The ABA recommends an amendment to the Bill to include a second criterion, a small business annual turnover test of less than $2 million, in the definition of "small business contract".

This would mean that the small business which is a party to the contract would be a business that employs fewer than 20 persons and has an annual turnover of less than $2 million.

This is supported by and is consistent with the business survey data included in the RIS for the Bill.

For the avoidance of doubt, the ABA strongly recommends the "small business contract" definition should be further amended to explicitly carve out the following:

1) A subsidiary or related party of a business that would not in itself be a small business.
2) Part of a corporate group that, collectively, would not be considered a small business.
3) A special purpose vehicle or joint venture vehicle associated with a business that would not itself be a small business.

On a cautionary note, if this suggested additional turnover test of $2 million were to be adopted in the Bill but increased, it would have the effect of extending the coverage of the Bill to more substantial businesses.

While the ABA's proposal would address one problem in the coverage of the Bill, a significant problem remains with the "upfront price" as applied to certain banking services including derivatives contracts.

The "upfront price"

The second key element constituting the "small business contract" is the "upfront price". It comprises two monetary thresholds; an "upfront price" not exceeding $100,000 and if the contract is for more than 12 months duration, where the "upfront price" does not exceed $250,000.

The ASIC Act currently defines "upfront price" to mean the price payable under the contract being -

the consideration that -

"(a) is provided, or is to be provided, for the supply under the contract; and

(b) is disclosed at or before the time the contract is entered into;

but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event."

The application of the "upfront price" under the Bill to certain business banking services contracts and including to some credit facilities is very unclear and should be clarified.

Otherwise, the scope and value of these transactions will extend to very substantial high value transactions and will be clouded with uncertainty as to where the legislation would or would not apply to those standard form contracts.

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The problem is that the use of the expression "upfront price" in the Bill, on present interpretations, would not apply to the transaction value of a particular contract but to the price payable (the consideration provided) for the financial service. Consequently, very significant high value transactions contracts will be caught because the "upfront price" or consideration payable would be neither significant nor, in some cases, ascertainable.

A key issue is the fact that this assessment is to made at a contract level rather than at the customer level, so while a customer may be sophisticated (e.g. as assessed by the bank) an individual contract could be caught. This will create confusion all round including as to when the customer should be considered as a small business and when not.

For this reason any financial product or financial service provided to a sophisticated client as described in section 761G (7) of the Corporations Act should be excluded from the Bill.

The third extract cited above from the RIS makes it clear that the intention is for the value of contracts to apply as the regulatory model rather than the consideration paid for the banking service.

Other particular concerns are:

4) Under proposed section 2BI (2) it is stated that "any other consideration that is contingent on the occurrence or non-occurrence of a particular event" does not form part of the "upfront price". For example, there is a variety of business banking products that involve a bank undertaking some form of contingent exposure at a customer's request (and the above words make it unclear whether those contingent exposures count for the purposes of the $100,000/$250,000 tests in the Bill). Examples include: bank guarantees (no advance of monies occurs until (when or if) the third party beneficiary calls on the guarantee), merchant facilities (where there are contingent exposures to the card schemes), financial markets (derivative) transactions and certain trade finance products.

5) In cases where the likely consideration to flow under a contract may be considerably greater than $100,000 per annum, it is uncertain when the contract is signed what the future consideration will be (and hence whether it will be "consideration that is provided or is to be provided" under 12B (2)(a)), for example, non-cash payment products provided by banks to small businesses where the amount the customer will pay is determined on a per transaction basis (with future transaction volumes being uncertain).

6) The Bill does not clarify whether it will apply to a bank providing an uncommitted credit limit to a small business (where the likely usage of that credit limit will exceed $100,000).

7) The Bill does not clarify whether a series of credit facilities provided to one customer or a corporate group are to be aggregated for the purposes of the relevant $100,000/$250,000 test.

There are many forms of business financial services contracts other than credit facility contracts which range from simple deposit facilities, non-cash payments systems facilities, insurance contracts through to complex, high value derivative contracts. In its previous submissions, the ABA has made detailed submissions about the challenges the current drafting pose in its application to non-credit business financial services products.

For example, with a deposit account, the consideration for the account would be the fee charged by the bank to maintain the account. The monetary thresholds described in the Bill would not apply to the amount of the deposit. Therefore there could be very substantial amounts well outside of the value thresholds in the Bill that would fall within the provisions of the Bill.

This would be the case even if the concern with the scope of the "small business contract" with respect to the meaning of a "small business" above is addressed.

For the payments system there are sets of rules for industry to observe, for example by the Australian Payments Clearing Association (APCA) and card scheme rules, where some of these rules may have to be reflected in a bank's contractual terms in, for example, a small business merchant agreement under which the bank acquires payments transactions for the merchant.

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In the case of derivatives contracts, they are governed by industry developed and agreed Master Agreements, for example the International Swaps and Derivatives Association (ISDA) Master Agreement that outlines the terms applied to a derivatives transaction between two parties and which have existed for many years without concern. Transactions may not take place for some time after a contract has been formed. Many of these are contingent facilities where the price will be unknown at the time the contract is made.

To avoid this potential overreach and uncertainty, the ABA recommends that the Bill should exclude business financial services contracts from the scope of the Bill, but otherwise by way of amendment to the Bill to:

1) ensure that the upfront price is redefined in the Bill as it applies to small business standard form contracts so that the thresholds in the Bill of $100,000 and $250,000 respectively refer to the value of the contract or transaction;

2) remove derivative contracts under subsections 761D(3) and (4) of the Corporations Act from the scope of Bill because of their complexity and because they would be little used if the "small business contract" question is addressed as suggested above; but

3) avoid doubt, exclude any financial product or financial service provided to a sophisticated client as described in section 761G(7) of the Corporations Act; and

4) to exclude market standard contracts prescribed by industry bodies (such as ISDA's Master Agreements) or contracts prescribed by foreign market participants.

Alternatively, as the ABA has submitted above that:

The "upfront price" should apply to the value of the financial product to which the financial service relates (see s761G Corporations Act 2001 and Corporations Regulations 7.1.11 – 7.1.28 for how the value is calculated as applying to various financial services products) for the purpose of the "upfront price" thresholds described in Item 8 clause (4) in Schedule 1 of the Bill.

A further point about the monetary thresholds described in the Bill is if these are removed or increased, particularly with respect to credit contracts, the risks for banks dealing with small and other businesses could increase accordingly.

2.2 Prudential considerations

Banks are prudentially supervised financial institutions regulated by the Australian Prudential Regulation Authority (APRA) which sets requirements on risk management standards that banks must meet.

To conform to APRA's guidelines, it is prudent for a bank to include in its credit contracts provisions covering a range of events which affect the financial position of a small business. These include:

- insolvency and pre-insolvency events;
- material adverse changes in the financial condition of the business;
- non-compliance with financial covenants;
- default interest clauses;
- changes in a bank's regulatory capital requirements; and
- increased costs clauses.

Importantly, many of these provisions provide the bank with better insight into the business customer.

This benefits the business if the business falls into difficulty with its credit facility. The bank is better positioned to assist the business and develop a work out strategy for the business.

Banks have business work out units which are specialised units within the bank made up of staff with skills in accounting, business restructuring, commercial management, insolvency and legal expertise.

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The work out area will assess the customer's financial and business situation with a view to managing the increased risk or loss minimisation. Any options identified by the bank are discussed with the customer.

The strategy adopted is dependent on individual circumstances. There is no one size fits all approach.

It may be appropriate to allow the customer more time to address certain key actions within a mutually agreed strategy.

This approach is consistent with the ABA's Code of Banking Practice when a small business customer experiences financial difficulty with its credit facility with its bank.

Without these provisions the business is at risk, as well as the bank, if a court determines that these provisions are not reasonable for the protection of the legitimate interests of the bank.

It is noted that under subsection 12BG (4) of the ASIC Act, there is a reverse onus of proof on the bank to disprove the presumption in subsection 24(4) that a particular contractual term is not reasonably necessary in order to protect the legitimate interests of the bank.

Moreover, an adverse court decision with respect to these type of clauses would have a systemic effect on risk management across the finance industry.

The ABA submits that the Bill should include an additional criterion in subsection 12BG (2) of the ASIC Act which the court must take into account when determining whether a term of a small business contract is unfair under subsection 12BG (1) with respect to an APRA supervised entity such as a bank.

Under the current drafting of the Bill, these conditions, which are necessary for a bank to meet its prudential requirements, could be challenged.

2.3 Commencement date

The proposed commencement date in the Bill is of real concern to our members. A period of six months after the Royal Assent to the Bill for banks to identify, review and amend where necessary their suites of standard form business contracts and amend necessary IT systems will be a time consuming task. The period of six months will be unworkable more so if the definition of a "small business contract" is not addressed as proposed in this submission.

As referred to in this submission, in the Schedule, there is a non-exhaustive list of banking products and services which are provided to small business customers under standard form contracts which banks and their related entities will be required to review and amend where necessary.

Some banks operate under a variety of brand names and have subsidiary companies which provide specialised services to some small business customers.

All of these entities will be required to review and amend, where necessary, their standard form contractual documentation and security instruments.

Incidentally, some of these entities may have fewer than 20 employees.

It is clear that the number and variety of contractual and security documentation applying to and available to small businesses will far exceed those documents which had to be reviewed for the commencement of the consumer unfair contract terms legislation under the ASIC Act in January 2011.

The process for banks will include:

- Assess and understand Feasibility, Legal assessment and the initial concept.
- Identify Business Requirements.
- Detailed Design, including mark-ups.
- Build and Install.
- Release of non IT changes completed.

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- Release of IT dependant changes.

A bank's IT systems will need to be engaged to make the necessary changes. For banks, it is not practicable to open their IT systems for making documentary changes on an ad hoc basis. For banks these windows are available only two or three times in a year. Specifications for making changes must be prepared and logged in advance in the queue of a bank's IT systems changes and scheduled for a timed IT release package in that year.

Banks implement an IT systems "freeze" from mid-December to mid-January to ensure that there are no IT systems change programs in train that could create problems with their banking systems during this high transactional activity period, including the high volume of small business transactions critical to their cash flows and payments to their suppliers and other creditors.

The ABA believes that a period of 12 months to implement these reforms should be provided for in the Bill.

This would be consistent with recommendation 31 of the Financial Systems Inquiry Final Report that with respect to compliance costs and policy processes for the government to:

Increase the time available for industry to implement complex regulatory change.

A possible way of managing these timing difficulties is if the Bill were to include a regulation making power as follows:

The Governor General may make regulations that:

(a) Exempt a person or class or persons form all or specified provisions of this Subdivision

(b) Exempt a contract or class or contract from all or specified provisions of this Subdivision;

(c) Provide that this Subdivision applies as if specified provisions were omitted, modified or varied as specified in the regulations.

The ABA is aware of a suggestion for regulators to provide industry with a "light touch" approach to compliance with the legislation for an additional period over and above the six months period. This suggestion would be of little comfort if it were to be implemented. It will be businesses seeking the assistance of the courts, industry based external dispute resolution schemes or other mechanisms to determine whether a contractual term is void.

If the Committee requires further evidence of this commencement date issue the ABA would be pleased to provide this further evidence.

The ABA would welcome a request from the Committee for amplification or clarification of any of the points made in this submission.

Yours sincerely

Ian Gilbert
Director Banking Services Regulation

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Schedule

Examples of deposit and transaction accounts and credit facilities available for small business customers

Business Finance

1. Working Capital (revolving facilities)

- Agribusiness overdraft
- Business overdraft
- Business credit facility
- Business credit card
- Invoice finance (debtor financing)
- Revolving line of credit for farmers

2. Term Debt (business loans)

- Agribusiness finance loan
- Principal and interest term loan - variable or fixed rate
- Interest only term loan - variable or fixed rate
- Interest in Advance Term Loan
- Business mortgage (secured) loan
- Tailored business facility
- Commercial bill of exchange facility
- Commercial investment property loan
- Tailored commercial facility
- Investment Facility – variable or fixed rate- for non-trading entities
- Interest rate risk management facility

3. Asset Finance

- Master asset finance agreements
- Equipment loan
- Finance lease
- Asset purchase
- Novated lease
- Chattel mortgage
- Hire purchase

4. Other

- Trade finance facility
- Project finance
- Foreign currency loan

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- Business package
- Trade package
- Bank guarantee
- Debtor finance
- Insurance premium funding
- Interest Rate Hedging/Products

Business accounts

1. Transaction Accounts

- Business accounts (multiple including cheque accounts and on-line accounts)
- Business offset account
- GST management account
- Primary producer account
- Emergency services account
- Business trust account
- Statutory trust accounts (solicitors, real estate agents, travel agents, conveyancers)
- Currency accounts

2. Savings / Investment

- Business online saver accounts (multiple)
- Farm management deposit account
- Term deposit
- Business cash management account

Payment Systems

- Bulk payments
- Direct entry – Debit
- Internet banking
- BPAY Biller/Payer
- Transaction negotiation authority
- International money transfers

Merchants

- EFTPOS
- Mobile EFTPOS
- Integrated EFTPOS
- Website payment gateway
- Online mail order/telephone order

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- Batch processing

Wealth

- Financial planning
- Investment common funds
- Income fund
- Self-managed superannuation funds (including lending, financing deeds and security trust deeds)

Bank internal Treasury contracts

- Foreign exchange and interest rate risk management derivatives

Security documents

- Mortgages of real estate
- Personal Property Securities
- Other security documentation