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**ASIC**

Australian Securities & Investments Commission

**Senate Inquiry into Access of  
Small Business to Finance**

**Submission by the Australian  
Securities and Investments  
Commission**

March 2010

## ASIC's submission

- 1 The Australian Securities and Investments Commission (ASIC) makes this submission to assist the Senate Inquiry into Access of Small Business to Finance (the Inquiry).
- 2 ASIC engages with small business stakeholders, and monitors available economic data and complaints from small business for systemic issues in relation to credit. However, ASIC's current jurisdiction in relation to small business and credit is limited. This submission also sets out some information on the financing requirements that may apply to small business.

## ASIC's consumer protection role

- 3 As part of its wider role, ASIC enforces and regulates company and financial services laws to protect consumers, investors and creditors.
- 4 ASIC administers various pieces of legislation, regulations, instruments and codes that impose consumer protection requirements on the financial services industry. Two principal pieces of consumer protection regulation that we administer and enforce are the *Australian Securities and Investments Commission Act 2001 (Cth)* (ASIC Act) and the *Corporations Act 2001 (Cth)* (Corporations Act).
- 5 The ASIC Act contains provisions that are modelled on the consumer protection and unconscionable conduct provisions in the *Trade Practices Act 1974 (Cth)*. The ASIC Act provisions cover broad standards of conduct, including prohibitions on unconscionable conduct (s12CA), misleading or deceptive conduct (s12DA) and false and misleading representations (s12DB). These provisions apply to the provision of financial products (including credit facilities) and services relating to credit facilities. ASIC's consumer protection jurisdiction under the ASIC Act extends to small business as consumers where the lender is a bank or any other type of finance provider.
- 6 ASIC's jurisdiction over financial products in the Corporations Act extends to small business as retail clients. Credit is, however, excluded from the definition of financial product in this legislation.
- 7 A small business is defined in the Corporations Act and the ASIC Act to mean a business employing less than:
  - (a) if the business is or includes the manufacture of goods—100 people; or
  - (b) otherwise—20 people.

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- 8 ASIC will take over the regulation of consumer credit and finance broking on 1 July 2010 under the *National Consumer Credit Protection Act 2009 (Cth)*. However, this legislation does not deal with lending for business purposes. Reform to credit legislation is being implemented in two phases. Regulation of the provision of credit for small businesses is being considered in Phase 2 of these reforms.
- 9 Currently the primary piece of legislation regulating consumer credit is the Uniform Consumer Credit Code (UCCC). The UCCC is administered by Australian states and territories and does not cover credit for business purposes.

### ASIC's consultation with small business in 2008

- 10 In early 2008 ASIC consulted with a range of small business stakeholders in relation to financial services and products including credit (the 2008 consultation). While this consultation did not identify issues of widespread or systemic misconduct by financial service providers falling within ASIC's jurisdiction, the feedback we obtained identified some concerns of small business.
- 11 Feedback from stakeholders from the 2008 consultation included the following issues:
- (a) *Small business credit products.* Some stakeholders expressed the view that credit products for small businesses can be quite complex and hard to understand. This can also make these products difficult to compare with each other.
  - (b) *Access to credit.* Some stakeholders commented on the difficulty in accessing small amounts of finance. Some stakeholders reported on requirements imposed by banks on small business that they perceived to be difficult or onerous. For example, some stakeholders reported the following:
    - (i) The family home was usually required as security. Security requirements were also often 'excessive' sometimes exceeding the loan by a factor of 10 or 15 times.
    - (ii) Applicants without equity in property had to show serviceability by financial statements or cash flow predictions.
    - (iii) The banks sometimes asked for multiple personal guarantees irrespective of the quality of the business, and blanket guarantees over assets in other entities unrelated to the transaction.
    - (iv) Applying for a corporate card required a lot of paperwork and the giving of a personal guarantee.

It was also reported that Indigenous applicants found it extremely difficult to access micro business loans through mainstream banking institutions and the various government-funded grants and subsidised Indigenous loan schemes.

- (c) *The use of 'de facto credit'*. Some stakeholders commented on the use of de facto credit by small business. Two main forms of de facto credit reported were tax liability and use of personal credit cards. It was reported that a proportion of small business used personal credit cards to ease short term cash flow, many unaware of the distinction between funds for personal use and business use.
- (d) *Serviceability*. Some stakeholders commented on the decreasing levels of service by banks and increased use of finance brokers for advice and information.
- (e) *Concern that barriers exist to switching banks*. Stakeholders commented that there were both perceived and actual barriers to switching banks with practical obstacles such as costs and time delays.
- (f) *Concern that there is a lack of specialised advice services for small business in financial stress*. Some stakeholders said that, while there are services to help start a business, there are minimal support services for a small business experiencing financial distress.

## Complaints by small business to ASIC

- 12 ASIC monitors the complaints it receives from small business. It is difficult to identify systemic issues from these complaints as the number of complaints we receive is very low.
- 13 From September 2009 there has been a 'Small Business Owner' category in the complainant type field of ASIC's complaints management database. We have received 37 complaints in this category from September 2009 to February 2010 (inclusive). This represents less than 1% of total complaints received by ASIC in the same period (6197).
- 14 Only one of the 37 complaints involved an allegation about the inability of the small business to access credit. It related to finance provided by a bank for an agricultural development. The complainant alleged unconscionable conduct by the bank through the termination of finance and application of default interest over a substantial period. The complainant also reported his inability to refinance. ASIC is making further inquiries in relation to this complaint.

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## ASIC's small business portal

- 15 The 2008 consultation indicated that, in some ways, small business behaves much in the same way as individual consumers. For example:
- (a) many small businesses tend to be unsophisticated relative to larger businesses, with little bargaining power and time;
  - (b) many small businesses are not aware of appropriate avenues for complaints (our discussions focused on complaints relating to credit and financial services);
  - (c) many small businesses acquire goods and services in much the same way as individual consumers;
  - (d) they are often required to use the family home as security and personal guarantees to secure the loan; and
  - (e) in some cases, personal credit cards are used to manage cash flow problems.
- 16 ASIC is developing a small business portal on its consumer website FIDO which should be finalised in the first half of 2010. The purpose of the portal is to explain concepts relating to small business credit, to suggest options for a small business in financial difficulty, and to direct small business to other sources of advice and information.

## Australian Government's Banking Guarantee

- 17 ASIC has been monitoring the market to ensure that appropriate disclosures are made to consumers so that they can determine if their product is covered by the Australian Government's banking guarantee (the initial guarantee was announced publicly in a Treasury release on 24 October 2008). ASIC has been particularly concerned to ensure that marketing material does not suggest that the guarantee is unlimited in time or amount, nor that the guarantee is provided without charge to the depositor if that is not the case. ASIC has not taken any formal action, but in a few cases has reminded lenders that their advertising must not be misleading.

## Financing requirements subject to the Corporations Act

- 18 Chapter 6D of the Corporations Act sets out fundraising requirements for Australian companies:
- (a) public companies can raise funds from the general public by issuing securities and will usually be required to provide a prospectus or other disclosure document to potential investors, such as an offer information

statement (OIS) which has lower disclosure requirements than a prospectus;

- (b) proprietary companies are prohibited from engaging in any activity that requires disclosure to investors under Chapter 6D, except for an offer of its shares to existing shareholders of the company, or employees of the company or of a subsidiary of the company.

19 An OIS could be used by public company small business ‘start ups’. ASIC has received a few inquiries from small business about the way in which funds can be raised and, where appropriate, we have made them aware of the OIS fundraising option.

20 The *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007 (Cth)* made some changes to Chapter 6D of the Corporations Act to facilitate fundraising for small scale offers and promote the creation and expansion of new businesses through easier access to capital. For example, the maximum amount that can be raised using an OIS was revised from \$5 million to \$10 million.

21 A proprietary company can only raise funds from investors in Australia through the offers of securities that are exempted from disclosure to retail investors. Section 708 of the Corporations Act sets out a number of different types of offers of securities that do not need disclosure. Small businesses are most likely to use the following exemptions:

- (a) small scale offerings (‘personal’ offers of a body’s securities where no more than 20 investors acquire securities and no more than \$2 million is raised by the issue of securities in any 12-month period);
- (b) offers made to specified people who are presumed not to need disclosure because of their financial capacity, experience, or wholesale status.

22 ASIC is also aware from our work in relation to unlisted and unrated debentures that, in addition to traditional forms of finance from banks and other Australian deposit-taking institutions (ADIs), some debenture companies are an alternative source for providing finance to small business.

## Overseas lending surveys

23 Currently, Australia does not have a dedicated senior loan officer survey to determine the supply and demand conditions prevailing in the small and medium-sized enterprise (SME) lending market. Such lending surveys currently exist in a number of countries including the United States of America (US), the United Kingdom, Europe and Japan, and have been useful in researching the lending demand and supply dynamics for both SMEs and large firms. For example, the US Federal Reserve issues the ‘Senior Loan Officer Opinion Survey on Bank Lending Practices’.

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- 24 It is open to the Inquiry to investigate whether it would be useful for a survey such as the US Federal Reserve's 'Senior Loan Officer Opinion Survey on Bank Lending Practices' to be issued in Australia. The web link to the US Federal Reserve's report for January 2010 is <http://www.federalreserve.gov/boarddocs/snloansurvey/201002/default.htm>.

## **Defining a 'small business'**

- 25 There are various definitions for small business. As mentioned earlier in this submission, the Corporations Act and ASIC Act define small business as employing less than 20 people, unless the business is or includes the manufacture of goods, in which case it is less than 100 people. The Australian Bureau of Statistics (ABS) also uses the maximum size of 20 employees, but makes an exception for agricultural businesses. For unfair dismissal purposes in industrial law, the upper size threshold for small businesses is 15 employees.
- 26 ASIC notes, however, that a mechanical application of these criteria can sometimes produce unexpected results. For example, a third of companies listed on ASX Limited have fewer than 20 employees but these businesses might have a quite different perspective on access to finance compared to a small family partnership or family company.