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Parliamentary Joint Committee on
Corporations & Financial Services
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INQUIRY INTO ACCESS FOR FOR SMALL & MEDIUM BUSINESS TO FINANCE

Introduction

The Australian Finance Conference (AFC) appreciates the opportunity to make a submission to the Inquiry. By way of background, the AFC was formed in 1958 as the national association of finance companies and has evolved into a non-institutionally-based financial services association. Our membership includes financiers involved in the bank as well as the non-bank sectors of the market. AFC caters for members' association/regulatory lobbying/compliance information needs, either directly or indirectly through our sister bodies (Australian Equipment Lessors Association, Australian Fleet Lessors Association, Institute for Factors & Discounters, Insurance Premium Financiers of Australia, Mortgage & Bridging Finance Association), in relation to their consumer and commercial finance activities across Australia, including consumer credit and housing finance, equipment leasing and financing, wholesale, factoring, receivables, bridging and insurance premium finance, retail deposit-taking and other fundraising activities.

General Comments

In the small and medium business (SME) space, as with other financial market segments, Australian financiers provide the full range of financial products found in comparable advanced economies overseas. For many years government policy at the States and Federal levels, in relation to SME finance has not been to create artificial protections but to allow market forces to operate freely subject to general Trade Practices prohibitions (eg. on false & misleading or on harsh & unconscionable conduct). As a result SMEs are able to access finance along their business model, track record and niche market spectrum at a risk-based price.

GFC and Medium-Term Consequences

Prior to the Global Financial Crisis (GFC) the Australian economy had experienced a lengthy period of growth. In parallel with this, growth in financial aggregates and markets had been buoyant, competition had been fierce and, at the margins, financial inclusion had been expanded as a growing mainstream lending industry had been able to provide services further along the risk spectrum. Given Australia's generally lower savings levels and the impact on available retail deposit funds due to the priority given to superannuation, financial intermediaries had needed to diversify their funding sources, particularly to overseas wholesale debt and securitisation markets.

From mid-2007, the lead-in to the GFC saw these markets, initially securitisation and then wholesale, tighten significantly and by the second half of 2008 close completely. The GFC's monumental consequences internationally are well known and are still playing themselves out. In Australia, the pre-existing fiscal and monetary policy positions, prudential and other regulatory frameworks and the generally sound management of the banking and finance institutions, meant a much lesser trauma. The Government's prompt action on retail and wholesale guarantees supported confidence in ADIs and its directions to the AOFM added liquidity to RMBS markets; also its fiscal stimulus achieved the preferred GDP and employment outcomes. In addition, the quality of the lending further along the risk spectrum locally meant that there were none of the "sub-prime" issues that added further shocks overseas.

The Australian financial market was nonetheless considerably affected by the GFC. Many overseas domiciled banks ceased new lending and over time repatriated their capital and/or debt and as several of these provided funding to local financiers, there was a multiplier effect on the reduction in competitors. Similarly, overseas non-bank financiers announced withdrawal from all or part of their local operations or were without funding due to truncation of the global credit line to and hence from, the parent. M&A activity among ADIs reduced the number of large as well as smaller players, both specialist as well as diversified. For domestic financiers which raised retail deposit funds but who fell outside of the Government guarantee, the curtailed fundraising ability that followed, meant absorption into their parent, cessation of business or capacity for new business matched only to loan repayments net of redemptions. Wholesale or private investment in local finance businesses virtually ceased and those competitors with business models premised on high leverage exited the market. As a consequence, the number of bank and non-bank intermediaries sufficiently "in funds" to be available to quote on new business applications or rollovers of existing lines was significantly reduced from earlier times. This was understandably compounded by prudential and commercial concentration ratios by client, by region or by market segment. Pricing also reflected the scarcity and costs of funding.

Over the last two and a half years funding markets have gradually improved; ADIs with and without assistance from the wholesale guarantee have topped-up with local and overseas liquidity; securitisation markets have shown modest recovery, more for RMBS than for other assets classes such as auto and equipment loans/leases; and several overseas parents' own boosted credit lines have become available locally. The quantum of funds is however subdued compared with five and more years ago and there is no sign of the re-entry of overseas, particularly US and European, players which previously underpinned directly or indirectly significant competition.

Government Guarantee

AFC supported the Government's guarantee of ADI deposits as it was vital to ensure confidence, stability and competition in the banking system at a very difficult time. An unfortunate result was the relative difficulty in retail funding created for non-ADIs and we believe more consideration should be given to temporary support mechanisms for the future.

In relation to the ADI sector specifically, AFC supports Government consultation with the industry to ensure that any changes to the operation of the deposit guarantee provided under the Financial Claims Scheme does not result in distortions to depositor access or perception leading to competitive disruption to future lending, including regional areas.

Also, because the expiry-date for the guarantee (12 October 2011) is less than a year away, and terms deposits will increasingly straddle that date, ADIs are keen for the Government to determine its policy so they may reassure depositors. The settling of policy well in advance should also avoid any sense of “crisis” or a repeat of the comparative disadvantage for non-ADI lenders.

SME Scope and Definition

Much difficulty and confusion in the discussion and development of SME finance policy is caused by imprecision as to what exactly is the subject of consideration, with the definition ranging from micro-businesses with no employees, through owner-managers with one or two employees, to businesses in the manufacturing industry with up to 100 employees falling within one or other of existing scopes. The fact that the latter definition in the Corporations Law captures some 97% of the private sector, highlights the risks associated with applying a policy solution which may be appropriate for one part of the SME spectrum to another part, with “unintended consequences” the predictable outcome.

SMEs and Risk

When lending to individual borrowers, the main risks affecting repayment likelihood that the financier has to take into account (over and above credit history and assessment) are unemployment, sickness and marital break-up. For SMEs generally, the risk to be assessed relates to the borrower’s business model and the unknown is fraud. At the smaller end of the SME spectrum, where owner-operators only are involved, all of the individual and business risks can be in play and the financier’s risk assessment can and should be cautious.

SME Security

Such caution notwithstanding, the SME sector (depending on how defined) makes up a large proportion of AFC members’ loans and leasing portfolio. For prudential and commercial reasons, mainstream lenders in Australia tend not to play the role of passive or silent equity investor in their SME client’s business, however, as previously noted, they can lend against the security of the full range of SME “assets”; from their debtors to the sale-and-leaseback of existing equipment. The Government’s actions to introduce a Personal Property Securities Register will support SME fund-raising capacity in this regard.

In Australia, SME principals and directors can also pledge their residential property as security in support of their enterprise. While due care is needed on behalf of both the SME and the financier, this ability underpins much SME commencement and expansion.

Regulatory Issues – Impact on SMEs

AFC has supported the Government moves for a national approach in relation to regulation in areas such as consumer credit, finance broker regulation, personal property securities, occupational health and safety laws and a national electronic conveyancing system.

These reforms carried out to a workable time-frame and with due regard to evidence-based best practice regulation-making principles, can reduce costs and foster competition. Absent this considered approach, regulation can be a major barrier to entry. For example, a large bank recently estimated its cost to comply with Phase 1 of the new National Consumer Credit legislation at $50 million and a former non-bank player, credited with boosting competition in the residential mortgage market from the 1990s, commented that such entry would not be practicable under the new regime.

Moreover Phase 2 of the NCCL is in the process of considering whether (if and/or how) “small business” finance might need to be included in its regulatory framework. Australia has a reasonable and realistic history of not regulating finance to SMEs as if they were to small amount consumer borrowers. Hardship provisions which may be appropriate to the individual consumer do not necessarily transfer to the SME business judgment space; a scenario where SMEs in business loss wish to be treated as consumers, while those in profit are proud to remain commercial, does not encourage the provision of finance. Best practice regulation principles should aim to ensure that any policy changes do not reduce the availability or increase the risk-based price of SME lending.

AFC would be pleased to provide further details as required.

Kind Regards,

Yours truly,

Ron Hardaker
Executive Director