Australian Government

Australian Small Business and Family Enterprise Ombudsman

27 February 2019

Committee Secretary
Senate Legal and Constitutional Affairs Committee
Parliament House
CANBERRA ACT 2600

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

Dear Sir/Madam

INQUIRY ON THE RESOLUTION OF DISPUTES WITH FINANCIAL SERVICE PROVIDERS WITHIN THE JUSTICE SYSTEM

Small businesses often lack the resources, knowledge, time and money required for lengthy legal battles. In financial disputes, when facing a large financial institution with deep pockets and expert legal teams, they are at a great disadvantage. This results in small businesses accepting settlements under duress as they can no longer afford to continue legal representation and must settle, even if their interests are not met.

Our *Inquiry into small business loans* in 2016 found that banks do not seek to resolve disputes in a fair or proportional manner. Our inquiry found that dispute generally arise when a loan facility is considered non-performing. Banks will aggressively seek to cover their risk moving rapidly to place a loan into default and engage insolvency practitioners to sell assets to recover funds. Banks procure these services to enable their own decision-making with regard to the loan security. Disputes over these services often end up with no access to justice as the banks say it is nothing to do with them as the third party is a representative of the business.

Where banks do enter into mediation, such as Farm Debt Mediation, the bank will attend with a team of legal representatives. The Primary producer will most likely be unrepresented. This disproportionate legal representation pressures the small business to agree to an unfair settlements.

Where a dispute progresses to the court system, as our 2018 survey of 1600 small businesses revealed, the average legal cost is $130,000. In addition, it can take up to two years for a case to be heard in court, and even longer for appeals from a bank to be resolved. The length of time is a major concern as banks regularly seek extensions to prepare for a hearing and to have appeals considered. Such practices push small businesses to insolvency. The combination of legal costs and time to be heard, both unknown at the outset, exacerbated by the absence of key operators from the business to attend preparatory meetings and court, gradually breaks the small business.

The formation of a single dispute resolution body, the Australian Financial Complaints Authority (AFCA), is a welcome step in providing access to justice for small businesses. As our submissions during the formation of AFCA highlighted, its terms of reference still allow the financial service providers to delay the resolution of disputes.

In particular;

- Time limits: even when a dispute has been through a banks internal dispute resolution (IDR) process, the first action of AFCA is to return a dispute to the bank for another review. We recommend that the outcome of an IDR process be considered the banks final position and that AFCA immediately commence its investigation. Further, that a maximum timeframe of six months be allowed from time of lodgement to AFCA to a determination.

- Compensation: currently AFCA offers up to $1 million to small businesses, $2 million for primary producers, for credit facilities up to $5 million. These limits do not capture capital intensive small businesses such as building and manufacturing which are forced directly into the legal system. We recommend an increase in the credit facility limit to $10 million with a proportionate increase to compensation.

- Membership: a financial service provider that holds a financial services or credit licence must be a member. This captures any provider of consumer credit but does not capture the many providers that exclusively offer commercial credit or third parties engaged by the banks that impact actions against borrowers. All providers of financial services and third parties engaged by providers should be required to have an external dispute resolution service and that should be AFCA.

- Promotion: small business borrowers assume financial service providers are covered by regulations and monitored by the financial regulators. Consideration should be given to all providers of financial services being require to prominently display if they have, and who, an external dispute resolution service.

The recent Royal Commission into the finance sector highlighted the breadth and depth of misconduct existing in the banking sector. This misconduct directly leads to disputes. The Commissioner's recommendations do not go far enough in affording better protection for small businesses simply identified the new Banking Code of Practice (Code) as the primary protection for small business. Yet the Code only applies to members of the Australian Banking Association, 23, compared to the more than 100 Authorised Deposit Taking Institutions regulated by the Australian Prudential Regulation Authority (APRA).

As we have raised in our response to the interim report from the Commissioner, the Code retains the power of the banks to do as they please as clauses that protect the small business borrower have a get out of jail sub-clause. For example, where the Code requires a lender to provide 30 days notice of a change to terms and conditions a lender can disregard the notice period, even provide no notice, where in its opinion it needs to do so to protect its interests.

Without significant protection in legislation for small businesses borrowers financial service providers will continue to use their position of power to force settlements that do not reflect a borrowers rights. Thank you for the opportunity to comment. If you would like to discuss this matter further, please contact [redacted].

Yours sincerely

Kate Carnell AO
Australian Small Business and Family Enterprise Ombudsman