



**ASIC**

Australian Securities & Investments Commission

**REPORT 348**

# **Response to submissions on CP 190 Small business lending complaints: Update to RG 139**

June 2013

## **About this report**

This report highlights the key issues that arose out of the submissions received on Consultation Paper 190 *Small business lending complaints: Update to RG 139* (CP 190) and details our response in relation to those issues.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes* (RG 139) and related Regulatory Guide 165 *Licensing: internal and external dispute resolution* (RG 165).

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## A Overview/Consultation process

- 1 In Consultation Paper 190 *Small business lending complaints: Update to RG 139* (CP 190), we consulted on proposals to refine Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes* (RG 139) so the Terms of Reference or Rules of an external dispute resolution (EDR) scheme may legitimately exclude certain types of small business lending complaints from its debt recovery legal proceedings jurisdiction.
- 2 A scheme's debt recovery legal proceedings jurisdiction is a specific jurisdiction an ASIC-approved EDR scheme must maintain under their Terms of Reference or Rules, so complainants can access EDR even if a scheme member has commenced legal proceedings to recover a debt or recover possession of an asset used as a security for a loan (usually a residential property): see RG 139.72–RG 139.77.
- 3 Under our proposal in CP 190:
  - (a) disputes involving small business credit facilities exceeding \$5 million would be able to be legitimately excluded from an EDR scheme's debt recovery legal proceedings jurisdiction by no later than 1 January 2014; and
  - (b) the \$5 million limit would apply to the single credit facility the subject of the small business credit dispute. This means that a scheme would not aggregate related loans or loans the subject of another small business credit dispute to determine whether the limit has been reached. A small business may have related loans or other small business credit facilities if they have multiple corporate entities and cross-guarantees.
- 4 We put forward this proposal because small business credit facilities of over \$5 million may involve more complex issues, and should therefore be more appropriately addressed directly in court.
- 5 This report highlights the key issues that arose out of the submissions received to CP 190 and our responses to those issues.
- 6 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 190. We have limited this report to the key issues.
- 7 For a list of the non-confidential respondents to CP 190, see the appendix. Copies of the submissions are on the ASIC website at [www.asic.gov.au/cp](http://www.asic.gov.au/cp) under CP 190.

## Background to EDR jurisdiction

### Complaints handling by EDR schemes

- 8 As a condition of their licence, Australian financial services (AFS) licensees and credit licensees must have a compliant dispute resolution system for handling retail client complaints. This dispute resolution system must consist of:
- (a) internal dispute resolution (IDR) processes that meet ASIC's approved standards and requirements; and
  - (b) membership of an EDR scheme approved by ASIC (unless the Superannuation Complaints Tribunal can handle all of the licensee's retail client complaints).
- 9 Two ASIC-approved EDR schemes currently exist to handle financial services and credit complaints. They are the:
- (a) Financial Ombudsman Service Limited (FOS), formed by the merger of five pre-existing ASIC-approved EDR schemes in 2008–09; and
  - (b) Credit Ombudsman Service Limited (COSL).
- 10 EDR schemes must maintain a debt recovery legal proceedings jurisdiction under their Terms of Reference or Rules. For information on the debt recovery legal proceedings jurisdiction, see paragraphs 5–9 of CP 190. For information on the rationale behind the jurisdiction, see paragraphs 10–16 of CP 190.

### FOS and COSL approaches to their debt recovery legal proceedings jurisdiction

- 11 ASIC approved FOS's Terms of Reference and changes to COSL's Rules as meeting the minimum requirements in RG 139.
- 12 FOS's and COSL's approaches to jurisdiction are summarised in paragraphs 17–21 of CP 190.

### Our review process

- 13 In December 2011, we released Consultation Paper 172 *Review of EDR jurisdiction over complaints when members commence debt recovery legal proceedings* (CP 172).
- 14 After all written submission to CP 172 were received, we met separately with key industry associations, consumer representatives and EDR schemes who had made submissions, to informally discuss their views. We also held a joint roundtable discussion with key stakeholders.

Note: For more information on our review, see paragraphs 27–33 of CP 190.

- 15 We issued CP 190 as part of the findings of our review, to seek feedback on a proposed refinement to RG 139 so the Terms of Reference or Rules of a scheme may legitimately exclude certain types of small business lending complaints from its debt recovery legal proceedings jurisdiction.

### **Phase II credit reforms**

- 16 The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* refines the National Credit Act, as it applies to personal loans, from 1 March 2013. The National Consumer Credit Protection Amendment Regulation 2013 No 1 introduces transitional exemptions from documenting hardship arrangements. This exemption applies until 1 March 2014.
- 17 After the close of the consultation period to CP 190, exposure drafts of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 (Credit Reform Bill) and National Consumer Credit Protection Amendment Regulation 2012 (Credit Reform Regulation) were released.
- 18 The Credit Reform Bill and Credit Reform Regulation proposed to introduce a new regulatory regime for credit providers who lend to small business. The reforms intended to increase obligations and protections for those with small business credit facilities that fell within the proposed ‘small business’ definition. We understand that after extensive public consultations, consideration of these small business lending reforms have been deferred.

## **Responses to consultation**

- 19 We received nine written submissions to CP 190 from a range of stakeholders, including industry, ASIC-approved EDR schemes and those representing small business interests (i.e. the Law Council of Australia’s SME Committee and the NSW Small Business Commissioner). We are grateful to respondents for taking the time to send us their comments.
- 20 The main issues raised by respondents related to how ASIC should limit a scheme’s debt recovery legal proceedings jurisdiction for small business credit disputes.

## B Updating a scheme's debt recovery legal proceedings jurisdiction for small business credit disputes

### Key points

We have updated RG 139 so an EDR scheme's debt recovery legal proceedings jurisdiction does not need to handle small business credit disputes where the credit limit of the small business credit contract (the subject of the dispute) exceeds \$2 million.

When determining whether the \$2 million limit has been reached, the scheme must apply the limit to the credit contract, the subject of the small business credit dispute. This means that where a small business has linked credit contracts, the \$2 million limit must be applied to the credit contract the subject of the dispute.

EDR schemes will need to update their Terms of Reference or Rules, and scheme processes to implement this change by no later than 1 January 2014.

### Access for small business borrowers to a scheme's debt recovery legal proceedings jurisdiction

- 21 Currently, small business borrowers are able to access a scheme's debt recovery legal proceedings jurisdiction when they have been provided credit by a member of the scheme and they meet the 'small business' definition in s761G of the Corporations Act.
- 22 Section 761G defines a 'small business' as employing fewer than:
- (a) 100 people (if the business manufactures goods or includes the manufacture of goods); or
  - (b) 20 people (otherwise).
- 23 As there is currently no limit on the types of small business borrowing disputes the scheme must handle, schemes must handle the dispute when such small business borrowers complain to a scheme to access the scheme's debt recovery legal proceedings jurisdiction.
- 24 In handling the dispute, the scheme must consider industry best practice. This may involve taking into account the ABACUS Mutuals Banking Code of Practice (clause 24) and the Australian Bankers' Association (ABA) Code of Banking Practice (clause 25.2), which both currently commit Code subscribers to assisting small business complainants in hardship.

- 25 Submissions to CP 190 expressed different views on how ASIC should appropriately limit a scheme's debt recovery legal proceedings jurisdiction for small business credit disputes:
- (a) two submissions supported our proposal of a \$5 million, non-aggregated limit in its entirety (FOS and the Law Council of Australia's SME Committee of the Business Law Section);
  - (b) one submission seemed to support the status quo being maintained (i.e. there be no limit), and commented that anecdotally, some small businesses take out \$5 million loans to undertake rapid growth when they may have little formal training in running a business (NSW Small Business Commissioner);
  - (c) two submissions suggested a lower loan value limit of \$2 million, as this would allow most small business borrowers to access an EDR scheme's debt recovery legal proceedings jurisdiction and would better reflect the RBA's definition of a small business borrower (Mortgage and Finance Association of Australia (MFAA), Angas Securities);
  - (d) two submissions suggested a lower loan value limit of \$1 million, as this would more appropriately capture 'at risk' small business borrowers and better reflect the loan value of the majority of bank loans provided to small business (Australian Finance Conference (AFC), ABA);
  - (e) one submission suggested a \$1 million loan value limit for single loan facilities and an aggregated \$2 million loan value limit where the small business borrower has multiple loan facilities, as this would cover 65% of their current small business loan book (Westpac Group);
  - (f) three submissions suggested alternative indicators for setting the limit:
    - (i) a net assets test, an annual business revenue test or annual income test (COSL, AFC, MFAA); or
    - (ii) a sophisticated small business borrower test (COSL); and
  - (g) one submission suggested that ASIC defer its policy response at this time until the small business lending reforms proposed by the Credit Reform Bill and Credit Reform Regulation are settled (AFC).

#### *ASIC's response*

We have updated our guidance in RG 139 for a scheme's debt recovery legal proceedings jurisdiction so:

- EDR schemes under their Terms of Reference or Rules must exclude certain types of small business credit disputes from their debt recovery legal proceedings jurisdiction (i.e. where the credit limit of the small business credit contract the subject of the dispute is greater than \$2 million); and



- where the small business credit contract the subject of the dispute is linked to another credit contract, the \$2 million limit must apply to the *single* credit facility relevant to the small business credit contract that is the subject of the dispute. This would mean that the value of all of the linked small business credit contracts would *not* be able to be aggregated to determine whether the \$2 million limit has been reached.

We expect EDR schemes to implement this change by 1 January 2014 and encourage schemes to do so earlier, if possible.

We have set the limit at \$2 million at this time, as supported by industry submissions, even though other submissions suggested a higher or lower limit.

We have done so because we are of the view that the existing position in RG 139—where all small business borrowers with credit disputes can access a scheme’s debt recovery legal proceedings jurisdiction—affects a scheme’s ability to operate efficiently and effectively. Submissions to CP 172 suggested that some form of limit is necessary to appropriately restrict certain types of small business borrowing disputes, as more complex, higher value disputes should be more appropriately dealt with in court.

We are of the view that a \$2 million limit best delineates between the types of small business credit disputes that are appropriately dealt with at EDR and those that would be more appropriately addressed in court.

This threshold intends to balance competing considerations between reducing compliance costs for industry and protecting consumers.

As a result, we decided not to proceed with a \$5 million limit at this time.

We have not set the limit at a lower threshold because we are of the view that the statistical data provided in most submissions does not completely illustrate whether the vast majority of small business borrowers, who are currently benefited by access to an EDR scheme, would not be significantly disadvantaged if the limit were to be set at a lower loan value. For this reason, we are cautious about setting the limit too low at a time when we may not have comprehensive or reliable data.

We have decided against using other suggested indicators to determine the limit, as we consider these other indicators would be difficult for a scheme to assess and may cause delays in the scheme determining whether they have jurisdiction. We are mindful that delays in assessing jurisdiction could detrimentally impact the interests of both small business borrowers and lenders.

We do not consider that loans that are secured by property should be treated differently for the purposes of determining the \$2 million limit, as submissions generally considered this to be unfair.

We consider that small business lending disputes involving farmers may continue to be addressed by other existing complaints mechanisms specifically established for farmers. Furthermore, EDR schemes may continue to exercise their discretion to exclude certain farming disputes from their jurisdiction where these alternative mechanisms may be the more appropriate forum for handling the dispute, or the dispute has already been dealt with in these forums.

We will continue to monitor the appropriateness of the \$2 million limit as part of our ongoing work to ensure the dispute resolution system operates efficiently and effectively for credit. As part of this approach, we will review the appropriateness of this limit, in the context of a scheme's debt recovery legal proceedings jurisdiction more generally, in two years time.

We encourage all stakeholders—EDR schemes, industry and representatives of small business borrowers—to continue to collect statistical data as this information will help inform our next review.

## Appendix: List of non-confidential respondents

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- Angus Securities Limited
  - Australian Bankers' Association
  - Australian Finance Conference
  - Credit Ombudsman Service Limited
  - Financial Ombudsman Service Limited
  - Law Council of Australia (SME Committee of the Business Law Section)
  - Mortgage and Finance Association of Australia
  - NSW Small Business Commissioner
  - Westpac Group
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