



ASIC

Australian Securities & Investments Commission

Small business and ASIC

*A speech by John Price, Commissioner,
Australian Securities and Investments Commission*

*Law Council of Australia and the Law Society of NSW SME Business Law Conference
(Sydney, Australia)
1 September 2017*

CHECK AGAINST DELIVERY

Introduction

Thank you for the opportunity to speak at today's conference. I am John Price, ASIC's lead commissioner for small business.

Small and medium enterprises make a significant contribution to the Australian economy. They account for 99.8% of all businesses registered in Australia, and employ almost 70% of our workforce.

Small business is ASIC's largest customer. Over 90% of the Australian companies and businesses registered with ASIC are small businesses with fewer than 20 employees. Small business alone employs half of Australia's workforce and makes up one-fifth of our gross domestic product. On the regulatory front, most of ASIC's financial services and credit licensees, as well as the users of the products and services provided by those licensees, are also small businesses.

Today I am excited to be able to tell you about ASIC's new Office of Small Business, and its work so far. I will discuss some improvements to our registry services, and will also take you through some of the resources we have developed in our efforts to support small business, and to show them 'what good looks like'. I will touch on the recent proposed changes to the external dispute resolution (EDR) framework, our work with unfair contract terms and our thoughts on the Banking Code of Practice Review. Finally, I will give you an update on our efforts to combat illegal phoenix activity.

ASIC's Office of Small Business and Small Business Strategy

Our vision is to allow markets to fund the economy and, in turn, economic growth. Regulating and supporting small business to succeed as a key driver of the Australian economy is an integral part of this.

In March this year, we established an Office of Small Business to focus our efforts with small business, and develop ASIC's Small Business Strategy.

Our Small Business Strategy focuses on three key elements: engage, assist and protect. We engage with small businesses, as well as our peer agencies and regulatory bodies, to understand and respond to the challenges and opportunities faced by small business. ASIC assists small business by providing efficient and effective registry services, and developing educational resources. We have helped protect small business through our work on unfair contract terms and combating illegal phoenix activity.

Registry services

I'd like to tell you a bit about what we're doing to improve our registry services.

We interact with small business on a daily basis, and most of it happens through our Registry function. We have been working closely with Government on the 'streamlining business registration measure' to implement changes, including:

- establishing a single online portal for business and company registration
- publishing application programming interfaces for Australian Business Numbers (ABNs), business names and company registrations
- reducing the number of business identifiers by making ABNs the primary identifier for both businesses and companies.

Another project that we are involved in is the National Business Simplification Initiative, announced in 2016. The aim of this initiative is to reduce the amount of time that businesses spend complying with regulations and interacting with agencies like ASIC.

Currently, Government is seeking feedback from the public on the improvements they would like to see to business registry services. This feedback will be used to identify how we can best deliver modern, cost-effective, secure and reliable registry services. No decisions have yet been made on the way forward. I encourage you all to review the discussion paper on Treasury's website, and make suggestions on how we can improve our registry services.

Small business resources and initiatives

Next, let's talk about our small business resources and initiatives. We are educating small businesses on 'what good looks like' through our initiatives, and by providing information to build financial capability in current and future small business owners.

In 2015, ASIC established an [Innovation Hub](#) to help fintech start-up businesses navigate the regulatory system without compromising investor and consumer trust and confidence. The majority of fintech start-ups are small businesses. The Innovation Hub assists these businesses by providing access to senior ASIC staff to streamline licensing processes. They also provide informal guidance to help bridge any knowledge and resource gaps. As part of the Innovation Hub initiative, ASIC is focusing on engaging with industry on the developments and opportunities in regulatory technology (also known as regtech).

In terms of our online resources, ASIC released its [First Business app](#) this year. It assists young people considering going into business for themselves. It provides practical tips, checklists, case studies and links to additional information on developing and running a small business. Since its launch in February this year, the app has been downloaded almost 6,000 times.

Our [Small Business Hub](#), located on our website, provides relevant and easy to access information for people starting, operating or closing a small business. It also contains a link to download our publication, *Running a small business in Australia: What you need to know*. This was republished in 2017 and translated and published in Simplified Chinese as well.

The [ASIC MoneySmart website](#) contains a range of information for those looking to start their own business, including the First Business online module, information on borrowing and credit, insurance, and general money management resources. The website also contains publications translated into 26 different languages, to assist our migrant community.

We also assist business through our Customer Contact Centre, taking inquiries on a range of topics such as registration, licensing, complaints and general queries.

More information on ‘what good looks like’ across the various industries we regulate, as well as all the resources I have just mentioned, is available on the [ASIC website](#). I encourage you to go and have a look.

External dispute resolution

People who are licensed by ASIC to provide financial or credit services generally need to be a member of an EDR scheme.

As it stands, small business is one of the key beneficiaries of the current EDR framework.

So why the need for change? One of the key small business related findings of the recent inquiry into EDR schemes (Ramsay Review) was that small businesses do not have adequate access to EDR.

Currently, two of the major EDR schemes, the Financial Ombudsman Service (FOS) and the Credit and Investments Ombudsman (CIO), have a claim limit of \$500,000, with a compensation cap of \$309,000 for small business. Where the dispute relates to a credit facility, the facility must not exceed \$2 million. The Ramsay Review found that these

caps are likely precluding small businesses from accessing EDR, forcing them through the court system for more costly and less timely outcomes.

There is also an issue in that the jurisdictions of the CIO and FOS overlap in some areas. This overlap creates the possibility of schemes competing in terms of beneficial outcomes for financial firms (or big business), as opposed to desirable outcomes for consumers or small business.

It can be difficult and unnecessarily complicated for small businesses to navigate the EDR framework due to the existence of multiple schemes. For example, where a dispute needs to be raised with multiple firms, firms can generally only be joined to a dispute where they are all members of the relevant scheme, even though they are related in terms of the actual dispute.

In relation to superannuation disputes, long delays in achieving resolutions means that some are redirected to courts, defeating the purpose of having a superannuation EDR scheme.

Changes to the EDR framework

The Ramsay Review recommended that a number of changes be made to the current EDR framework.

Establishment of Australian Financial Complaints Authority

The Government has agreed with the Ramsay Review's recommendation to replace the existing three bodies with a single, 'one stop shop' service for financial disputes. It will be called the Australian Financial Complaints Authority (AFCA), and will be established as a public company limited by guarantee, operating under a co-regulatory framework.

This means that while AFCA will be charged with making its own decisions in terms of staffing, dispute resolution processes and funding, it will be subject to legislative and regulatory requirements as determined by government and ASIC. ASIC will be granted general directions powers to oversee the body.

The shift to the new EDR framework will be gradual, with AFCA set to commence operations from 1 July 2018. Existing disputes will continue to be dealt with by the respective existing EDR bodies.

Increased monetary limits for disputes

One of the specific changes that will be made in terms of access to EDR for small business is the increase in monetary limits for disputes. The Government has agreed with the findings of the Ramsay Review that the current caps must be increased. The following figures are subject to consultation between AFCA, ASIC and industry stakeholders, but the Ramsay Review suggested that, for small business disputes (other than credit disputes), the monetary limit be increased from \$500,000 to \$1 million, with a compensation cap of no less than \$500,000. For credit disputes, small businesses will be

able to bring a claim where the credit facility is up to \$5 million, with a compensation cap of up to \$1 million. Superannuation disputes will continue to have no monetary limit.

In order to ensure that its decisions are binding, all financial firms, as well as regulated superannuation funds (excluding self-managed superannuation funds) and approved deposit funds, will be required under legislation to be members of the scheme.

Desired outcomes of these changes

These reforms will lead to a variety of positive outcomes.

First, it will increase access to EDR for small businesses. By increasing the monetary limits for disputes, a greater proportion of small businesses will be able to access avenues for redress.

Second, it will make EDR easier to navigate for all consumers, removing the confusion around existing EDR schemes and issues around related firms being members of different schemes.

Finally, the merge should reduce the regulatory costs associated with maintaining three separate bodies.

Unfair contract terms and the Code of Banking Practice

Small businesses enter into standard form contracts for financial products and services every day. Lending practices to small businesses have been the subject of a number of reviews and inquiries in recent years. A common theme that emerges is the lack of negotiation power held by small business – standard form contracts are often presented to small businesses on a ‘take it or leave it’ basis, leaving small business consumers with little choice in the matter.

These contracts are usually lengthy, complex documents. As we know, small business owners are generally time-poor. This can lead to them entering into contracts they do not fully understand, due to the often pressing need for capital.

There is no question that lenders usually hold the balance of power. The majority of these standard form contracts contain financial covenants to protect the lender from risk. For example, loan-to-valuation ratio covenants enable lenders to call a default when the value of secured assets falls, despite the customer having met their repayment obligations.

Further, the Code of Banking Practice is written in a language that is not familiar to most small business owners, having been written from a legalistic perspective. In the event of a dispute, this leaves small businesses with the option of seeking professional legal advice, which is costly and can be time consuming.

Actions to address these issues

In November 2015, government passed legislation extending unfair contract term protections contained within the *Australian Securities and Investments Commission Act 2001*. They now also cover standard form small business contracts entered into, or renewed, from 12 November 2016. The protections apply where the upfront price payable under the contract does not exceed \$300,000 – or \$1 million if the contract term is greater than 12 months.

Following a round table hosted by the ASBFEO and ASIC, the big four banks have committed to comprehensive changes to ensure all small business loan contracts entered into (or renewed) since 12 November 2016 are protected from unfair contract terms.

So far, the big four banks have committed to a range of improvements to their standard form contracts for small business borrowers. These improvements include:

- removing from loan documents ‘entire agreement clauses’ that absolve the bank from responsibility for conduct, statements or representations they make to borrowers outside the written contract
- significantly limiting the operation of indemnification clauses. For example, banks will now not be able to require their small business customers to cover losses, costs and expenses incurred due to the fraud, negligence or wilful misconduct of the bank, its employees or a receiver appointed by the bank
- removing clauses which gave banks the power to call in a default for an unspecified negative change in the circumstances of the small business customer (known as ‘material adverse change event’ clauses). So, banks will now not have the power to terminate the loan for an unspecified negative change in the customer’s circumstances
- restricting the banks’ ability to vary contracts to specific circumstances and, where such a variation would cause a customer to want to exit the contract, the banks will allow between 30 and 90 days for the consumer to do so.

The banks have all modified their positions in response to our expectations, although they have taken different approaches – including some going further than the law requires – when responding to our concerns about some of these clauses.

In addition to direct contact with the big four banks, ASIC has released an information sheet to provide guidance on how the new laws deal with unfair terms in small business contracts for financial products and services. It describes the protections that are available for small businesses and ASIC’s expectations of all businesses. [Information sheet 211](#) *Unfair contract term protections for small businesses* (INFO 211) is available on the ASIC website.

As a result of the Code of Banking Practice Review, also known as the Khoury Review, the Australian Bankers’ Association is currently re-drafting the Code. ASIC will be requested to approve the Code. We think this will help to instil consumer confidence in the Code, as approval requires a number of minimum standards to be met.

As it stands now, sign up to the Code is not mandatory. The Khoury Review has recommended that banks and other financial services licensees be required to subscribe to the Code. Treasury is currently consulting on this issue as part of the ASIC Enforcement Review. More information on this can be found on the Treasury website.

Small business contracts that are covered by the Code will also be covered by the unfair contract terms law.

ASIC also supports the recommendation that the Code be rewritten in plain English. This will enhance small business consumers' ability to interpret the Code, and thus their rights in relation to their contractual relationship with subscribing banks.

Desired outcomes of these actions

We are working towards levelling the playing field for small business in the financial products space. Through our efforts on unfair contract terms, small businesses will be able to access fairer standard form contracts and a greater ability for negotiation, with reduced exposure to risk. We also look forward to seeing positive changes being implemented as a result of the Khoury Review.

Combating illegal phoenix activity

Combating illegal phoenix activity has been a big part of ASIC's work for a while now.

Before I continue, it is important to distinguish between legal and illegal phoenix activity. From ASIC's perspective, illegal activity occurs where directors of a failed company deliberately deny unsecured creditors access to the company's assets. These unsecured creditors are usually small businesses and employees.

The unfair competitive advantage that operators get by engaging in illegal phoenix activity has a significant impact across a variety of sectors, including small business.

Quantifying the impact of illegal phoenix activity on the Australian economy is an extremely difficult task. However, a PricewaterhouseCoopers report commissioned by the Fair Work Ombudsman in 2012 estimates that the total annual detrimental cost of illegal phoenix activity to the Australian economy is up to approximately \$3.19 billion.

Proposed reforms and actions being taken

ASIC undertakes regular enforcement action to combat illegal phoenix activity, primarily aimed at those who are directly involved in, or facilitate this behaviour. We are a part of a whole-of-government approach to combating illegal phoenix activity through the Phoenix Taskforce. We make examples of the worst offenders and target specific industries known to be most at risk of engaging in illegal phoenix activity.

We undertake surveillance work focused on potential future misconduct, aimed at directors of current companies with a history of involvement in alleged illegal phoenix activity.

We also work with the insolvency profession in order to combat illegal phoenix activity through the Liquidator Assistance Program and the Assetless Administration Fund. The Liquidator Assistance Program aims to ensure that directors of companies under external administration comply with their obligations to assist the appointed liquidator. The Assetless Administration Fund is a Government fund set up to finance preliminary investigations and reports by liquidators into seemingly assetless companies where illegal phoenix activity is suspected. During the 2016–17 financial year, ASIC prosecuted 409 individuals through the Liquidator Assistance Program, and banned 31 company directors from managing corporations.

While any change is a matter for Government, ASIC has previously suggested consideration of various reforms that might protect against illegal phoenix activity. These include:

- *A phoenix offence provision.* Currently, no statutory definition of illegal phoenix activity exists. The law might be amended to include a specific offence provision to target illegal phoenix activity, rather than the symptoms of the activity. This would assist liquidators to claw back assets to make available to the creditors of the initial company, as well as allow ASIC to better address illegal phoenix activity as an offence.
- *A transaction intervention power.* We suggested that, where illegal phoenix activity is suspected due to the transfer of assets between companies occurring at less than or no market value, a regulator may issue a notice to the second company to prevent this from occurring.
- *A Director Identity Number.* We suggested that directors be allocated a Director Identity Number be used in their interactions with ASIC. Not only will this help to minimise the use of fictitious director identities, it will assist us to better track directors and help identify those who manage corporations whilst disqualified.
- *A cab rank rule.* We are concerned that potential conflicts are occurring as a result of the current referral process for the appointment of liquidators. We suggested that a ‘cab rank rule’ be implemented for appointing liquidators, as this would promote independence and greater confidence in the process.

Conclusion

With our efforts in enforcement, surveillance and education – and the support of law reforms – we will continue our work to level the playing field for small business.

Thank you for listening, and I encourage you all to visit our website, have a read of our Small Business Strategy brochures in your conference packs and seek further information on the issues I have discussed today. I am happy to take any questions you may have.