



Shaping the future with confidence

Your business post-Financial Services Royal Commission

Detailed analysis

ROUND 3: LENDING PRACTICES TO SMALL AND MEDIUM ENTERPRISES

Throughout the Royal Commission, Commissioner Hayne grappled with the difficulties of striking an appropriate balance between ensuring that small and medium enterprises (SMEs) have access to credit, and imposing standards on the provision of that credit to protect SME borrowers and third-party guarantors.

After hearing from many stakeholders of the difficulties likely to arise from increased regulation in this area, Commissioner Hayne ultimately determined the issue called for no substantive legislative change.

BUSINESS AS USUAL

1. Extension of the NCCP

One of the key issues the Commissioner examined was whether lending to SMEs should fall within the reach of the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP**). Currently, the NCCP does not apply to lending for business purposes.

Following the Interim Report's conclusion that there was no substantial support for changing the legal framework regulating SME lending, in particular by extending the NCCP to cover SME lending, it is unsurprising the Final Report recommends the NCCP not be extended to cover this form of lending. Instead, Commissioner Hayne tells us to 'apply the law as it stands'.

This means the prohibitions contained in the NCCP will not apply to SME lending, including the requirement not to enter a credit contract:

- (a) unless the prescribed inquiries and verification have been made; or
- (b) if the contract is unsuitable.

Commissioner Hayne decided not to extend the NCCP to SMEs in recognition of the need to ensure that small businesses have access to reasonably affordable and available credit.

2. Guarantors

The Commissioner also considered making amendments to the existing guarantor framework, since third-party guarantees are commonly taken in support of loans to SMEs.

However, the Final Report concluded no changes need to be made to the existing law in relation to guarantees. In so doing, Commissioner Hayne tipped his cap to the diligent work already completed by his fellow High Court judges in ensuring appropriate protections for voluntary guarantors, referencing two leading High Court decisions (one of which he presided over).

The Final Report noted that the 2019 Banking Code of Practice (the **Code**) had also introduced new protections in this area relating to both enforceability and the bank's requirement to assess the principal debtor's ability to service the loan. Commissioner Hayne concluded these developments were desirable and sufficient.

CHANGES MADE TO SME LENDING

Despite the Final Report making very few substantive changes to the SME lending framework, it did make two recommendations in this area.

1. Definition of 'small business'

Commissioner Hayne concluded that the definition of 'small business' in the Code is 'too complicated and too confined in its reach'.

As a result, the Final Report recommended the Australian Banking Association (**ABA**) amend the definition of 'small business' to apply to any business or group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than \$5 million.

This definition was first put forward in the 2017 Khoury Review as an alternative to the three-part test currently set out in the Code.

2. Enforceable codes

As outlined in our detailed analysis of [Round 1](#), the Commissioner recommends:

- that the ABA and ASIC take steps to identify those provisions of the Code that should be enforceable; and
- that the law be amended so that a breach of those provisions will be a breach of the law, with remedies available equivalent to those now set out in Part VI of the *Competition and Consumer Act 2010* (Cth).

The effects of these changes on lending to SMEs include:

- **Dealings with AFCA (formerly FOS):** The Commissioner observes that if breaches of enforceable code provisions result in contraventions of statute, this will help reduce systemic issues identified in entities' dealings with FOS. This may mean that SMEs may elect to enforce any breach through the courts rather than through external dispute resolution mechanisms. The Commissioner notes it would be for the customer (or guarantor) to elect which path was to be taken in seeking redress.
- **Industry engagement and dealings with ASIC:** The Commissioner observes that ASIC's role in reviewing the proposed enforceable code provisions must go beyond being the 'passive recipient' of industry proposals. Key industry players, such as the ABA, may need to substantiate the basis for identifying those provisions that govern, or are intended to govern, the terms of the contract made between the financial services institution and SMEs.

The Commissioner states that while it is time to give certainty and enforceability to key code provisions that govern the terms of the contract between the financial services entity and the customer or a guarantor, he does not intend to interfere with the broader development or operation of industry codes.

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