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Australian Financial Complaints Authority (“AFCA”)

By email: [submissions@afca.org.au](mailto:submissions@afca.org.au)

SUBMISSION PAPER:

# Consultation Paper AFCA changes to identify financial firms in published determinations

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Prospa Advance Pty Limited (“Prospa”) welcomes the opportunity to provide feedback on AFCA’s proposed rule changes.

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## 1. A little about us – “Prospa”

The use of online small business lenders such as Prospa by Australian small businesses is increasing, due to our ability to provide online application processes, timely credit decisions and funding, unsecured finance, repayment flexibility and an excellent customer experience.

As awareness increases, we expect small business owners will increasingly consider online small business lenders as an alternative to traditional lenders.

Increased awareness has been driven by several factors including:

- Increased number of industry participants;
- Increased marketing investment by industry participants;
- Increased media discussion of online lenders; and
- The Australian Government reference to online lenders as a viable alternative source of finance for small business owners (at both the State and Federal level).

Prospa is currently Australia’s #1 Online Small Business Lender<sup>1</sup>, operating out of our Sydney headquarters. Prospa has supported small businesses with funding of more than \$1 billion and employs over 240 people in Australia.

Prospa offers Small Business Loans between \$5,000 to \$300,000 and a Line of Credit for up to \$25,000. All customers of Prospa are small businesses with all funding decisions achieved by assessing well over 450 data points, including turnover, profit & loss, business tenure, size and industry sector.

Prospa has developed a sophisticated risk-based scoring methodology developed over our more than seven years of lending to small businesses. We verify the specifics of every small business applicant using data from sources such as (but not limited to): ASIC’s website, Equifax, bankstatements.com and the Australian Tax Office.

All applications are processed using Prospa’s bespoke secure online and phone application process, querying data sets that determine overall approval limits and risk-based pricing.

## 2. Impact Prospa has on the Australian economy

A recent independent study conducted by RFi Group and the Centre for International Economics on behalf of Prospa, revealed the positive economic impact of Prospa’s lending to small business in Australia. See full report [here](#).

The research showed Prospa lending between 2013 and 31 December 2018 contributed \$3.65 billion to Australian nominal GDP and helped maintain 52,500 annual FTE positions. These findings demonstrate that by providing small business owners with fast, simple access to finance, Prospa is not just directly contributing to its customers’ revenue and jobs, but to the wider Australian economy.

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<sup>1</sup> Market position for online balance sheet lenders to Australian small businesses, based on Prospa’s volume as a percentage of total market volume in 2017 as reported in KPMG “The 3rd Asia Pacific Region Alternative Finance Industry Report”, November 2018; USDAUD FX rate of 0.767.



### 3. Importance of Self-Regulation

Achieving the right level of regulation to keep small businesses moving in today's economic environment is critical. Prospa's overall purpose is underscored by this sentiment by making reasonably affordable credit available to all small businesses, safely, fairly and with the customer's best interest put first.

Self-regulation is something Prospa has a deep commitment in achieving, partnering with the Australian Finance Industry Association (AFIA) and six of Prospa's fellow online small business lenders to establish AFIA's Online Small Business Code of Lending Practice ("the AFIA Code").

As part of the AFIA Code, participating signatories have introduced a standardised pricing disclosure tool with six pricing metrics to their loan contracts, and a clear and concise loan summary before a loan is accepted by the customer, making it easier for all small business owners to make educated financial decisions for their specific business.

Kate Carnell AO, Australian Small Business & Family Enterprise Ombudsman, publicly supports the adoption of the OSBCLP as shown in a recent video:

<https://www.youtube.com/watch?v=gtoWmE28McQ&feature=youtu.be>

In addition, the AFIA Code requires lenders who are signatories to establish their independent membership with AFCA even though the law does not impose EDR membership directly. Should AFCA choose to publicly name small business lenders without adequate context or with a level of unbiased fairness, this could result in signatories of the AFIA Code seeking to amend the Code to remove the requirement for membership of AFCA. Prospa is concerned this would have a significant impact on the compliance standards across this sector of the lending market.

### 4. Importance of Prudent Lending

Prospa is in the business of extending funding options to its small business customers fairly, prudently and with adequate levels of skill and good will. We have developed and rely on our own Prudent Lending Framework ("Framework") to determine the creditworthiness of small businesses requesting funding from us.

#### **Measuring verification quality using loss rates**

Prospa's risk appetite dictates our business model, and how we determine and assess serviceability, and our acceptable loss ratios. Loans that are repaid on time and in full are profitable, delinquent loans and defaults are not. It is in the interest of lenders, especially online lenders like Prospa, to ensure that as much as possible we adjust our risk settings to ensure we lend to customers who can repay us.

Prospa's low delinquency rates are testament to the effectiveness of our Framework which is continually reviewed and monitored. Adjustments can be made as required to take into account factors such as macro-economic trends, our desired portfolio performance and the seasonality of Australia's small business sector.

#### **Determining what is reasonable**

Prospa strongly advocates that the expected level of enquiry and verification outlined in RG209 can be **practically** achieved through available means whilst not losing sight of the true spirit and intent behind

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the law i.e. making **reasonable enquiries** that are **scalable** and take into consideration the customer's **requirements** and **objectives**.

Imposing verification requirements that cannot be achieved in a timely digital manner will remove an incentive for customers to consider using an alternative lender. This would have the unintended consequence of reducing competition and present a poor customer outcome. With the advent of Open Banking, timeliness of customer response will become even more important.

## **Small business lending has a different use of funds profile**

The use of funds for small businesses is very different to that of consumers. Instead of consuming funds immediately upon receipt on a 'consumable' good or service, small business owners invest in goods and services that will enable them to maintain or grow their business. They invest in ways to increase output and jobs. Prospa queries use of funds closely as we do not provide funds for debt consolidation or other negative uses.

## **Small businesses are more volatile**

Lenders need to ascertain a profile of the small business applicant then make a risk-based determination around the applicant's capacity and willingness to repay without risk of suffering financial hardship. This assessment isn't about **preventing** a customer from falling into hardship, it's purely an assessment done at a **point in time** which factors in all known and disclosed financial details, personal circumstances surrounding each individual applicant and the details that could reasonably be verified at the time of application.

## **When things go wrong**

However, things don't always go as planned for a small business. Their customers may be late paying, there could be a natural disaster or staff could leave suddenly. Circumstances can change quickly through no fault of the business owner.

Lenders **cannot** be held liable for how customers manage their finances post approval. Poor money management decisions on the customer's behalf are not the responsibility of the lender and this needs to be reinforced within RG209, on sites such as ASIC's "MoneySmart" and throughout consumer financial educational materials prepared and promoted by government, regulatory bodies and consumer advocates.

Lenders and their respective funding partners require a sustainable level of comfort and support when enforcing their contracts and should be able to do so without unwarranted fear or threat of regulator / AFCA intervention (assuming of course all contracts are fit and proper, meet Unfair Contract Term standards and an adequate credit assessment was undertaken). That "moment in time" credit decision must not be ignored or used against the lender later down the track.

In addition to standard financial hardship policy options, Prospa believes all lenders should build into their customer management programs an element of "fairness" with options costed for and made available to customers who do experience unforeseen changes with their financial circumstances during the term of

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their loan contract and be helped without fear or threat of significant penalty or detriment. Often, if genuine flexibility is offered early, instances of financial hardship can be avoided.

Taking a balanced approach between enforcement of contract terms and the ability to adapt and assist customers when appropriate to do so helps to build trust, customer loyalty and belief in the credit sector.

## 5. Incorrect application of NCCP standards has a negative impact on small business funding

As indicated in our submission to ASIC last month regarding their revision of Regulatory Guide 209 (“RG209”), if drafted appropriately, will provide the desired level of clarification industry requires. If the revised RG209 does not address the current inconsistencies around what and who are regulated by consumer protection laws, this could have unintended consequences to small business funding for years to come.

The same applies to AFCA’s treatment towards small business contracts in the event a dispute is raised. ASIC RG209 guide needs to consider technology advancements and the ever-increasing expectations of consumers and small business customers since it was first drafted. Much has changed!

Whilst Prospa made no comment throughout CP309 regarding “Consumers” seeking credit for personal, household or domestic purposes - as Prospa **does not** lend to this cohort of Australian consumers - it’s important the boundaries that separate “Consumer Credit” from “Small Business Funding” are well defined within ASIC’s revised RG209 to achieve clear understanding across Australia’s Credit sector, regulators, consumer advocates and most importantly, AFCA.

Today, there is much confusion and varying opinions around when responsible lending provisions (as defined within the National Consumer Credit Protection Act (“NCCPA”)) apply to small business funding and when they don’t. Prospa encourages AFCA to help clarify this area by not applying NCCPA standards to small business lenders. A real concern exists if AFCA can “name and shame” when the incorrect standard has been applied.

In many cases over the past 3-4 years, the definition of what constitutes a “small business contract” has been inconsistent across this stakeholder group making it extremely difficult for Prospa and those in the business of small business funding. In some cases, this lack of clarity will have resulted in unnecessary declines and / or costly dispute resolution outcomes through AFCA with no benefit to the customer.

Therefore, Prospa strongly encourages AFCA to consider carefully, that NCCP provisions **do not** extend to small and medium sized businesses. This is consistent with Commissioner Hayne’s conclusion post the recent royal commission into Australia’s Banking, Superannuation and Financial Services sector<sup>2</sup> and recommendation **1.9 – the NCCP Act should not extend to ‘small business’ lending.**

Prospa adopts the Small Business definition:

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<sup>2</sup> Final Report – Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Section 5 Lending to small and medium enterprises.

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*“any business or group employing fewer than 100 full-time employees, where the loan applied for is less than \$5 million”.*

Prospa’s adoption of this small business definition is consistent with Hayne’s recommendation **1.10 – Definition of ‘small business’** and The ABA within their updated Banking Code.

AFCA’s own rules need to align to existing law, and ASIC’s interpretation of the law as outlined in their regulatory guides, the same way small business lenders (such as Prospa) are required to do. Prospa recently reviewed its suite of contract documents which were ratified by external law firms and ASIC. Prospa must be able to rely on the enforceability of these contracts to remain viable, and to confirm funding arrangements, without fear of AFCA undermining their enforceability. Prospa will be making special mention of this as part of our own submission on RG165, which deals with changes to Internal Dispute Resolution (IDR) processes and where ASIC proposes to publish IDR data at both aggregate and firm level.

It’s understood that AFCA already has the ability to report any identified or suspected cases of systemic non-compliance to ASIC so Prospa would encourage AFCA utilise this more suitable method of reporting untoward or non-compliant behaviour versus publicly publishing Financial Service Provider details within determination notices.

## 6. Flow on effect of the proposed rule change

The proposal to change AFCA’s rule to name a small business lender (such as Prospa) that is the subject of a determination, without any background detail, context or acknowledgment of the attempts made by the small business lender to reach an amicable outcome, not only has negative consequences for the small business lender, but undermines the fairness of the EDR process. As a direct result, small business lenders may withdraw their membership with AFCA and in some extreme cases, may withdraw offering small business finance altogether.

AFCA’s April Newsletter talked about AFCA’s commitment as a new organisation to be open, transparent and more accountable to the public so Prospa would be interested in understanding in more detail, the evidence AFCA is relying on to justify the proposed rule change, specifically around small business lending.

Prospa would welcome the opportunity to work with AFCA as a priority to better understand the basis for the proposed change and collaboratively develop a solution to address that issue while maintaining the integrity of AFCA as a fair, well informed, respected EDR scheme. Prospa main purpose is to “keep small businesses moving” so minimising any detrimental and unwarranted impact to small business owners’ access to finance is paramount.