Submission

Productivity Commission Draft Report: Competition in the Australian Financial System

Commercial & Asset Finance Brokers Association of Australia

2018

CAFBA

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Association of Australia

Productivity Commission
4 National Circuit
Barton ACT 2600

12 March 2018

Submission in response to the Draft Report on Competition in the Australian Financial System

The Commercial Asset Finance Brokers Association of Australia Limited (CAFBA) is a strong voice for issues within the commercial finance sector. This submission builds on our initial submission to the Productivity Commission in in September 2017. CAFBA has given consideration to the draft recommendations within the Draft Report and believes that the Productivity Commission must make minor adjustments and include additional recommendations.

We are pleased by the way the Productivity Commission has gone about examining competition in the Australian financial system through this inquiry and report. CAFBA commends the willingness of the Productivity Commission staff to engage with our organisation; however, CAFBA would welcome the opportunity to participate in a specific roundtable or forum with other interest groups focused on SME finance to further articulate our views.

CAFBA members are professional commercial finance brokers committed to providing the best quality service to our business clients. Our members are eager to ensure that the Draft Report enables SMEs in Australia to have greater flexibility in access to finance. CAFBA is pleased to see that the report goes some way towards addressing some of our concerns; however, we remain particularly worried that the draft report does not focus enough on SME finance or the POS exemption.

The following submission contains the response of CAFBA to a number of specific recommendations within the report. We also advocate adopting additional recommendations, as highlighted in our original submission.

The CAFBA board members, staff, and our members are eager to continue working with the Productivity Commission and are willing to make ourselves available to assist you with the development of final recommendations.

Yours sincerely,

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Background on CABFA

The Commercial & Asset Finance Brokers Association of Australia (CAFBA) is the peak national body of commercial equipment finance brokers, whose prime area of business is the distribution of commercial equipment finance facilities to their clients. With over 700 members, in all states and territories, CAFBA is an important national voice in the Australian finance sector.

CAFBA members are career professionals, with recent studies showing nearly 67% (East & Partners 2017) of new commercial equipment finance is sourced through brokers. Our members and their clients are predominantly small to medium-sized businesses and operate in the commercial finance market. The total receivables in the Australian equipment finance market are approximately $100 billion, so it is an important component of the Australian economy.

CAFBA members know that providing Australian small businesses with access to finance is crucial to economic growth. Although brokers are commonly associated with home loans, CAFBA members work in a complex environment to provide a boutique service. Without the work of CAFBA's professional members, many Australian small business owners would struggle to navigate the complexities involved with commercial equipment finance.

CAFBA embodies the strengths of its members in a unified approach for dealing with financiers and legislators at a national level and regularly seeks the views of members. As an association, CAFBA provides the framework and support to professionally assist our members in their daily activities. This involves education and training, legislative and regulatory updates and forums where the members can interact and exchange ideas with their peers.

CAFBA prides itself on being self-regulating and maintains strict membership standards on probity, continuing professional development, industry experience, and reputation. It is a condition of CAFBA membership that commercial equipment finance brokers must belong to an ASIC-approved External Dispute Resolution Scheme.

CAFBA is a member of the Council for Small Business Australia and works collaboratively with the government, regulators, and business groups.

Response to Specific Recommendations

CAFBA board members and our staff have considered the proposed recommendations contained in the Draft Report and have chosen to make comment on those most important to our members.

Recommendation 8.2

CAFBA represents both commercial and asset finance brokers in Australia and so our activities, industry sector, and clients are vastly different from that of the personal finance, mortgage broking and NCCP regulated credit environment. We were pleased to see that the Draft Report segmented consumer and SME finance in Recommendation 8.2 by focusing on mortgage brokers specifically.

Recommendation 9.1

We support the recommendation to allow a broader schedule of risk weights in Australian Prudential Regulation Authority's (APRA) Prudential Standard APS 112. Adoption of this recommendation would enhance the ability for SME's to not always provide the family home as the only form of security when seeking to obtain business funding. CAFBA members understand that this can cause significant stress in families and is often a significant factor in deciding to proceed with or limit future business investment. This has the flow on impact of reducing economic growth and job creation.

Due to the low-risk weightings on home loans and high-risk weighting on commercial loans, it is more economic for banks to focus on using the family home as security for finance in preference to SME loans or commercial equipment finance. This practice has created a product imbalance and an environment where banks are not necessarily recommending the most appropriate product for businesses.

We believe that APRA must conduct an immediate consideration of how APS 112 could be reformed. SME lending is a significant issue for the broader economy as SME's employ nearly 45% of the Australian workforce. As the report outlines, the standardised approach applied by APRA provides for a single risk weighting of 100% for any SME lending that is not secured by a residential mortgage. There is no delineation by size of borrowing or form. This differs to the Basel II standardised risk weightings where SME lending below €1 million Euro is covered as retail lending and a risk weighting of 75% applies. What the current weighting also does not address is that in commercial equipment finance there is an underlying asset i.e. the equipment that is the subject of the financing, that has real intrinsic value and supports the loan. Further modelling is required to recognise the value of this security. Analysis by APRA in conjunction with Basel II and Basel III to address these anomalies could provide a better outcome and cheaper cost of funds for SME lending.

Reform of APS 112 will produce even greater benefits if done in tandem with reform of APRA Prudential Standard APS 113.

In summary, APS 113 requires banks to carry specific capital and more closely monitor any customer exposure over AUD $1 million. The standard was created in February 2008 in response to the Global Financial Crisis, and was based on the €1 million Euro model adopted across Europe. At the time, the AUD equivalent was around AUD $1.6 million, and the threshold figure has never been indexed.

If APS 113 had taken the currency value and CPI rises into account, the threshold would now be approx. AUD $2.5 million, which is a far more appropriate figure for capital adequacy requirements and customer account management.

CAFBA sees the current AUD $1 million threshold as an unnecessary level of red tape, a cost to lenders and an impediment to lending. We continue to make this point with APRA, The Reserve Bank, and of course the relevant ministers with whom we are in regular contact. CAFBA made a strong case for raising the threshold in its submissions to the Financial Systems Inquiry, and we respectfully submit to the Productivity Commission that APS 113 is worthy of your consideration for review.

Recommendation 14.1

CAFBA is supportive of a deferred sales model for sales of add-on insurance by car dealerships. Car financing is an important issue for the government to address and associated issues are currently being reviewed by Royal Commission as prepared in their Background Paper 3. CAFBA is of the opinion that Recommendation 14.1 in itself does not address the ongoing issue of the "temporary" Point of Sale (POS) exemption that was granted in 2009 to the motor vehicle industry from having to hold an ACL/ACR when dealing as a credit intermediary for regulated credit. This ongoing point of sale exemption would mean that Recommendation 8.2 would not apply to a large number of credit intermediaries in the motor vehicle dealership channel. CAFBA calls on the Productivity Commission to ensure that this recommendation goes further, or that an additional recommendation is made, to ensure that the POS exemption issue is addressed.

The Royal Commission Background Paper 3 states: *"ASIC indicates that the majority of car dealers engage in credit activities by relying on the supplier of goods and services exemption, rather than as credit licensees or as credit representatives. In these cases, the obligation rests on the ACL holder, rather than the car dealer, to ensure it complies with the National Consumer Credit Protection Act 2009 (Cth)."* (4.2.3 pp. 12)

The Royal Commission Background Paper 4: *"The point of sale exemption is commonly used in stores selling white goods and electrical items to allow an application for credit for the purchase of those goods to be processed 'in-store'. The point of sale exemption is similarly used in car finance.*

Some regulatory concerns have been expressed about the point of sale exemption and whether it is compatible with the philosophy of the NCCP Act licensing conduct and responsible lending regime. As yet there have been no legislative proposals to remove the exemption." (4.2.2 pp. 24)

CAFBA has raised our concerns regarding the POS exemption to the Australian Government on various occasions (see attached list). We have met with representatives from ASIC on this matter who advised that they need a direction from Treasury to act on the POS exemption. ASIC has recently (2017) highlighted and taken action in relation to the provision of consumer finance through car dealerships. Our previous submission to the Productivity Commission in 2017 highlighted why this remains of significant concern to CAFBA members.

Prior to the commencement of the National Consumer Credit Protection Act in 2010, the previous Labor Government exempted point of sale (POS) vendor introducers from the requirements of the Act. The exemption thus applied to those who engage in credit activities at the point of sale. The specific exemptions included excluding those POS vendor introducers from the credit licensing regime and the responsible lending obligations. This exemption has remained in place for almost a decade and is an area of broken policy from the previous government that remains in need of repair.

CAFBA members, who are professional equipment finance brokers, are not exempt from the Act, and are bound by its rule when arranging finance for consumers, providing protection for consumers and sector-wide standards for brokers of consumer finance. This is something that CAFBA supports for the benefit of all, but in particular to ensure that consumers in Australia are protected.

The outcome is brokers of consumer finance fall into 2 broad classes; those who are required to be licensed and those who are not, simply because they are vendor introducers. In our view, a broad-based vendor exemption for consumer finance introduced at the point of sale is no longer tenable. It was intended to be an interim exemption for 12 months to allow the Government to consider the market and processes in greater detail. It is now approaching 9 years, with deep and distinct business and competitive disadvantages.

The negative consequences of POS exemption are that it provides an opportunity for high-risk consumer finance to be provided. The exemption opens a window of opportunity for inexperienced individuals with limited training to provide low-quality services to consumers. This is concerning.

Businesses providing financial services with a POS exemption:

- Are not required to meet any entry standards and ASIC is also unable to exclude vendor introducers from the credit market
- Can select, recommend or propose credit products without having to conduct an assessment as to whether the product is suitable for the consumer, or meets their financial requirements or objectives.
- Limit the ability of consumers to access remedies for the conduct of vendor introducers.

These characteristics are at odds with the requirements of finance brokers, such as many

CAFBA members who are licensed to arrange consumer finance, complying with the Act and applying responsible lending practices. The alternative to licensing is for brokers to act under the licence of a broker or a credit provider/lessor by being appointed its credit representative.

The exemption, therefore, does not provide any means of adequately regulating or controlling the activities of POS vendor introducers who may cause loss or damage to consumers, despite their linked credit providers/lessors being responsible for their conduct.

Consumers rely on their financial provider to give them a high-quality service when making any purchase. The variety of pressures placed on the staff of car retailers, combined with varying experience, or inexperience, in providing financial service can negatively impact on consumer experiences.

The risk of harm is more likely where the POS vendor introducer has selected the financier on the basis of the commissions they will receive if finance is approved, where those commissions increase the cost of finance paid by the consumer. The exemption also means that there is a lack of competitive neutrality between POS vendor introducers and other businesses, like licensed CAFBA members, which are performing similar functions.

How well-informed a consumer is about their car purchase and financial options should not depend on the practices of dealers involved. All dealers that are involved with providing finance options for car sales at the point of sale/ time of sale should be experienced professionals and be trained in providing services specific to their client's needs.

Of concern to CAFBA is the way some consumers may misunderstand the protections available to them when accepting finance from POS vendors. Car buyers may believe that they have full protections when they obtain dealer finance and, through a lack of awareness of POS policy and legislation, they place unwarranted faith in what they are told by car dealers which make them even more vulnerable than the exemption itself and even easier prey for unscrupulous operators.

The Competitive and Consumer Act (C&C Act) promotes competition and fair-trade markets to benefit consumers, businesses, and the community. CABFA holds the strong view the current vendor introducer exemption to the NCCP Act is at odds with objectives of the C&C Act. Conduct by businesses in an Australian market is meant to be such that does not have a substantially adverse impact on competition or detriment to the broader consumer interest. The only occasions on which conduct should run counter to this is if the law believes it is the public interest to do so. The Australian Competition & Consumer Commission, the Australian Competition Tribunal and the courts are arbiters of the public interest.

CAFBA understand specific laws, such the POS vendor introducer exemption can override the essential tenets of the C&C Act. Despite this, the continuation of that exemption cannot be sustained in the public interest. The anti-competitive effect of continuing the exemption is the significant financial and compliance investment by licensed brokers in meeting their licensing and responsible lending obligations and in maintaining them over the longer term.

By comparison, POS vendor introducers merely have to follow what their linked credit providers /lessors train them in and instruct them to do. There is no investment in POS standards, consumer protection or consumer disclosure. And, at its worst, the structural issues can result in a significant disadvantage by consumers paying more for their finance than they may have otherwise, resulting in potentially a significant financial benefit to the POS vendor introducer.

The anti-competitive consequences of the current POS vendor introducer exemption are very real to the consumer finance broker market. It is, to our mind, bad public and competition policy to have different regulatory models and outcomes for the same processes/ services unless it is demonstrably in the public interest to do so. CAFBA does not see competition law public benefit in keeping the current POS vendor introducer exemption.

Timeline of communication with the Australian Government in relation to POS exemption

2013

- Submission to Treasury Discussion Paper *"National Consumer Credit Protection Act 2009 – Point of Sale (POS) Vendor Introducer Exception"* – 25 MAR 2013

2014

- Submission to the Financial System Inquiry 31 MARCH 2014

- Submission to the Financial System Inquiry 25 AUG 2014

2015

- Submission to ACCC – "Proposed Acquisition of Esanda Dealer Finance Division – 7 AUG 2015

2016

- Letter to ASIC regarding ASIC response to Flex Commissions – 29 FEB 2016

- Submission to AISC Consultation Paper on Flex Commission – 28 JUN 2016

2017

- Submission to Senate Standing Committee on Economics – 3 MAR 2017

- Submission to ASIC *"Consultation Paper 279 –Flex commission arrangements in the car finance market*" – 27 MAR 2017

- Submission to the ACCC *"Draft Report of the New Car Retailing Industry Market Study"* – 7 AUG 2017

- Submission to Productivity Commission "*Inquiry Into Competition In The Australian Financial System"* – 15 SEP 2017

- Submission to ASIC Consultation Paper *"The Sale of Add-On Insurance and Warranties Through Caryard Intermediaries"* – 23 OCT 2017

- Spoke with representatives of both ASIC and Treasury during 2017