

AFCA tips scales for banks against small business

The Australian Small Business and Family Enterprise Ombudsman's (ASBFEO) 2016 *Inquiry into small business loans* found an "almost complete asymmetry of power" in the relationship between small business borrowers and the banks. This manifested in predatory lending practices, conflicts of interest and "significant gaps in access to justice ... with borrowers having limited resources and banks having overwhelming resources".

For many small businesses that fall victim to the banks, the only avenue to attempt financial dispute resolution is the Australian Financial Complaints Authority (AFCA), which was established in 2018 and largely replicated the structure of its predecessor, the Financial Ombudsman Service (FOS).

The 2016 ASBFEO inquiry received feedback from complainants that they believed the industry-funded FOS lacked independence from the banks. Notably, when a dispute was considered by an AFCA decision-maker last year (many of whom were transferred over from FOS), AFCA decided in the firm's favour 78 per cent of the time, increasing to 80 per cent of the time if the matter involved a bank. Additionally, AFCA's Lead Ombudsman for Small Business, Suanne Russell, is a poacher-turned-gamekeeper who joined AFCA immediately from working as a lawyer heading Westpac's business lending division.

In its 2016 inquiry, the ASBFEO observed that FOS's (and therefore AFCA's) processes advantaged banks because they were familiar with the mediation process, and because "small business lenders are aware that if agreements cannot be reached, banks will likely enforce their legal rights (for example, by taking possession of a property or appointing a receiver) ... The practical effect of this is that many small businesses accept 'settlements' that they may not have accepted if the threat of enforcement by the banks had not been there."

If a small business opens a complaint with AFCA, this halts any court proceedings while AFCA is considering the dispute; however, if AFCA consents, a bank can still freeze, preserve or sell the complainant's assets, including their car or family home.

Furthermore, if a small business accepts AFCA's decision, the bank may ask them to provide a binding release of liability. AFCA finger-wags at the banks, stating that it expects this release to be drafted fairly, not introduce new terms or allow the bank to recover more than the agreed settlement or AFCA's determined amount. AFCA will not provide legal advice to a complainant about the effect of a release, but will only "conduct a limited review", instead advising complainants (who, notably, are accessing AFCA's services because they can't afford legal costs) to seek legal advice.

In its regulatory guidance for AFCA, the Australian Securities and Investments Commission (ASIC) states that, "to the extent it is practical to do so", AFCA is expected to oversee dispute settlement arrangements to ensure that complainants are not entering into them as a result of duress or misinterpretation. However, because AFCA is not subject to parliamentary oversight or any form of external review, there is no evidence that this oversight actually happens.

AFCA's monetary limits inadequate for small business needs

The 2016 Ramsay Review, which ultimately directed the design of FOS' successor, AFCA, observed that it was difficult to obtain an accurate picture about the extent of small business lending. This was also the experience of a concurrent review undertaken by FOS, which was examining its small business jurisdiction, including its monetary and compensation limits. In its submission to the Ramsay Review, FOS described its "limited success" in obtaining small business lending data from ASIC, Treasury, and the bank regulator, the Australian Prudential Regulation Authority (APRA); and observed that the Reserve Bank of Australia's published data for small business lending over \$2 million was aggregated and did not include transaction numbers, meaning the data may be skewed.

FOS' submission observed that outstanding business debt in Australia had expanded at a rate of 2.7 times greater than inflation over the previous two decades, at an annual compound growth rate of 6.8 per cent. This growth increased financial risk exposure and the potential value of small business dispute claims. FOS had commissioned modelling from KPMG to inform its position on recommended changes to FOS's jurisdiction, and was confident that an analysis of the data supported an increase of the small business compensation limit to between \$1 million to \$2 million (up from \$309,000), and an increased monetary limit which would allow FOS to consider credit facility claims of up to \$5 million for debt-related disputes (up from \$2 million). Furthermore, FOS stated that there could be grounds to support an increased jurisdiction of \$2 million compensation and \$10 million credit facility claim limit; FOS had previously proposed this increase for debt-related disputes in a consultation paper for its 2016 review of its small business jurisdiction. This proposal was based on FOS's analysis of small business complaints it had previously received.

The Ramsay Review ultimately recommended a compensation cap of \$1 million and a credit facility claim limit of \$5 million. For all other non-credit related small business disputes, the Review recommended a \$500,000 compensation cap and \$1 million monetary limit.

AFCA implemented the Review's recommended monetary and compensation limits, with the addition

of a higher compensation cap of \$2m for primary producer credit facility claims. Notably, as responsible lending obligations do not apply to small business, AFCA will not take these laws into account when assessing small business loan complaints. In its governing legislation, AFCA was mandated to undergo an independent review eighteen months after commencing operation. This included a specific requirement that the appropriateness of AFCA's monetary limits be examined in relation to credit facility disputes involving primary producers; however, the legislation did not make any specific requirements about the monetary limits for other small businesses.

This review was conducted out of Treasury, which published its final report in August 2021. Treasury acknowledged that although small businesses (including primary producers) represented a small proportion of AFCA's overall complaints, the amounts at stake were often very large. Treasury acknowledged that the ASBFEO and the National Farmers Federation had recommended increasing the monetary limits for primary production and small business complaints to \$10 million and compensation to \$5 million. The Citizens Party has documented the experience of two small businesses owners who have attempted dispute resolution with AFCA after bank maladministration caused the catastrophic collapse of their finances: Michael Sanderson (primary production) and Goran Latinovich (construction), estimated their financial losses at \$12m and \$20m, respectively. ([AAS, 26 January 2022](#))

Despite acknowledging evidence that several small businesses had been excluded from accessing AFCA's services because their claims exceeded AFCA's monetary limits, Treasury denied that this indicated a widespread problem with the current limits. However, Treasury admitted that the documented number of complaints which had been excluded from AFCA "may not accurately reflect the volume of demand for AFCA dispute resolution above the current limits", because small businesses "may have decided against contacting AFCA in the first place for matters that clearly exceeded the limit." The Ramsay Review made a similar observation.

AFCA's submission to Treasury's review cited its own data to assert that its monetary limits were adequate and did not need to be changed, claiming that only a small number of small business complaints had been excluded because they were outside of AFCA's monetary limits.

However, there is a discrepancy between AFCA's claims and the experience of its predecessor, FOS. FOS's previous proposal of a \$2 million compensation cap and \$10 million monetary limit for debt-related disputes was based on FOS's own analysis of previous small business complaints it had received which showed a "clustering" of such disputes around the \$8-10m range, although FOS acknowledged this was based on a small sample size. Because AFCA is not subject to external review or parliamentary oversight, the underlying data supporting its claim that its small business monetary limits are adequate cannot be properly vetted. Treasury's review did not recommend any changes to the status quo, however, instead recommending that AFCA should continue to use its own complaints data to determine whether increases to monetary limits were warranted in future.

Additionally, Treasury stipulated that AFCA's compensation limit for non-financial losses (capped at a paltry \$5,400) should not be increased because, unlike other existing tribunals, AFCA's decisions are not subject to review mechanisms— which is a recommendation of Treasury! In its review, Treasury was insistent that AFCA's decisions should continue to not be subject to further merits review.

AFCA's lack of accountability, bias in favour of financial firms and inadequate monetary limits only exacerbates the "almost complete asymmetry of power" between small businesses and banks.

By Melissa Harrison, Australian Alert Service, 2 March 2022

Further reading:

[Financial complaints umpire AFCA is part of the problem](#)
[The City of London origins of AFCA](#)
[Australia's financial system was designed for plunder](#)
[ASIC overhaul requires paradigm shift](#)