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SUBMISSION PAPER:

Regulation Impact Statement Enhancements to Unfair Contract Term Protections

This Submission Paper was prepared by Prospa Group Limited (ACN 625 648 722). www.prospa.com.au

Prospa Group Limited (“Prospa”) welcomes the opportunity to provide feedback on Treasury’s Regulation Impact Statement in relation to enhancements to unfair contract term protections.

1. A little about us – “Prospa”

Prospa is currently Australia’s #1 Online Small Business Lender¹, operating out of our Sydney headquarters. Prospa has supported small businesses with funding of more than \$1.4 billion and employs over 250 people in Australia.

Prospa offers Small Business Loans between \$5,000 to \$300,000 and a Line of Credit for up to \$100,000. 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 uses a sophisticated risk-based scoring methodology developed over our more than seven years of

¹ 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.



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.

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: https://howto.prospa.com/rs/317-LRS-411/images/PRO028_EconomicImpactReport_FA03_Digital.pdf.

Based on the results of this study, Prospa has contributed \$5.6 billion in total to Australian nominal GDP and helped maintain 80,000 annual FTE positions since 2013. 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.

3. Improving access to credit for small businesses

The Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry emphasised the need to ensure that small businesses have access to reasonably affordable and available credit.² We believe that the goal of both protecting small businesses and improving access to credit for small businesses is best served by proportionate regulation that is fit-for-purpose. This requires a bespoke regulatory approach to small business lending, which takes into account the particular characteristics of small businesses, as compared to consumers. It also requires proportionate responses by regulators, based on the tenure of the lending category, the lender and the asset class as well as the overall impact of the conduct being regulated (in this case, the unfair term) on small businesses. The impact on competition and access to credit for small businesses should also be considered.

We believe that as online small business lending is a relatively new lending category, government support can increase awareness and consideration of online small business lending amongst small businesses. This is supported by independent research undertaken by the RFi Group. According to this research, whilst awareness of alternative lenders (such as online small business lenders) amongst small businesses has increased, consideration of alternative lenders by small businesses has remained steady since December

² Final report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, page 95.

2017, with a dip between July 2019 and December 2019. Further, of the factors that small businesses reported as making them feel comfortable about using alternative lenders, government support was one of the top three factors. In the context of this research, we believe that regulatory action against a single online small business lender could reduce the consideration of alternative lenders, as a category.

4. Flexible Remedies

We advocate for a regulatory model for remedies that achieves the following objectives:

- Where a term is determined to be unfair, a court should have the powers necessary to enable the contract to survive and continue to be enforceable;
- A regulator should not have a broad, blanket power to commence proceedings on behalf of a class of small businesses.

We have responded to specific questions raised in the section of the Regulation Impact Statement titled “Flexible Remedies”, below.

Question 10: If a court determines a term or terms in a standard form contract small business contract are unfair, should it also be able to determine the appropriate remedy (rather than the term being automatically void)?

We believe that a term that is determined by a court to be unfair should not be automatically void. Rather, the court should be able to make orders that would enable the contract to survive.

The current law can force a situation where a contract is rendered unenforceable

We agree with the statements made in paragraph 5.1 of the Regulation Impact Statement as to the position under the current law, which we summarise as follows:

- If a court declares that a particular term in a standard form contract is unfair, then that term is automatically void.
- If the contract is capable of operating without the void term, the rest of the contract continues to bind the parties.
- If the contract is rendered unworkable after the term is voided, then the parties cease to be bound by the contract.
- The court can make orders that it thinks fit to compensate, in whole or in part, or prevent or reduce, the loss or damage suffered by the small business party.

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- However, due to insufficient provision in the current law (summarised in paragraph 5.1 of the Regulation Impact Statement), the court may be unable to make orders that have the effect of allowing the contractual arrangement to continue, even where this is beneficial to all parties.

In summary, the current law can force situations in which the contract ceases to operate, with the effect that all parties are in a worse position than if the contract were on foot. We agree with the recognition in the Regulation Impact Statement that, in these cases, “the contract-issuing business could lose revenue from the contract falling through, while the small business may lose access to critical goods and services”.

If a credit contract is determined to be unenforceable, this can have a material impact on credit providers and small businesses.

Specific issues arise in the case of credit contracts. If credit contracts are rendered inoperative and unenforceable, this can have material impact on credit providers. More specifically, if a credit contract was determined to be unenforceable, and by extension all contracts using that term were unenforceable, this would potentially trigger covenants in relation to funding lines, causing them to be withdrawn and potentially triggering a liquidity crisis for the lender. This would have the effect of placing all the small business customers of that lender in a worse position than if the contract were on foot, because it would also trigger the withdrawal of funding to all those small businesses. This can have the overall effect of making affordable credit less accessible for small businesses and reducing competition and generating poor customer outcomes.

The court should therefore be able to make any orders (including to vary the contract) that enable the contractual arrangement to remain on foot.

We believe that the court should be able to make those orders that enable the contractual arrangement to remain on foot, where this is the most beneficial outcome for all parties in each case. For instance, a court should have the power to vary the terms of the contract to enable the contract to continue. The term that is determined to be unfair should not be automatically void.

Question 11: Do you consider a regulator should be able to commence court proceedings on behalf of a class of small businesses on the basis that an unfair term has caused or is likely to cause the class of small businesses to suffer loss or damage?

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We do not agree that a regulator should be able to commence court proceedings on behalf of a class of small businesses on the basis that an unfair term has caused or is likely to cause the class of small businesses to suffer loss or damage.

A. The power enables regulators to overstep the role of a regulator

If, as an outcome of proceedings commenced by a regulator in relation to a class of small businesses, a particular term is determined to be unfair, this would have the same effect, in practice, as deeming the use of that term to be *unlawful*

If proceedings commenced by a regulator resulted in a determination that a particular term was unfair, then the likely practical effect (and notwithstanding the legal position), would be that the term could not be used in *any* contracts with small businesses. On this point, we note that it is industry practice for credit providers to generally use standard contract terms across all classes of small businesses to which the credit provider offers credit. Credit providers are unlikely to offer contracts containing terms determined to be unfair to a particular class or classes of small businesses. In particular, the AFIA Online Small Business Lenders are required, on an annual basis, to produce a legal opinion that certifies their loan contract complies with current UCT legislation and regulation and any current legal precedent, in order to be certified as being compliant with the Code.

Given these implications, the power enables unfair terms to be rendered effectively unlawful at any moment in time. That is, the power would enable regulators to create de facto regulation that prevents the use of particular contract terms. Accordingly, we believe that the power would allow regulators to overstep the parameters of a regulator's role.

The power has the effect of extending the regulator's role to that of a class action lawyer

On our interpretation, the scope of the power would allow a regulator to commence proceedings on behalf of a class of small businesses for an order of damages (in addition to a determination that the term is unfair and therefore automatically void). This has the effect of extending the role of the regulator to that of a class action lawyer. We believe that this is outside the scope of a regulator's role.

On a related note, the operation of the "likely to cause" trigger (i.e. the ability of a regulator to exercise the power where the term is "likely to cause" loss or damage) is unclear. For instance, it is unclear how regulator would assess whether or not a term is likely to cause damage. No specific test is defined for a regulator to use in order to assess the "likely to cause" trigger, so application could therefore be subjective and has the

potential to be loosely interpreted by a regulator in order to prosecute a public agenda. This is of particular concern where such prosecution, even if unsuccessful, could cause reputational damage to a specific credit provider, a credit business model or a nascent industry sector.

B. A more proportionate response is needed

We reiterate that a proportionate response is needed by regulation in order to achieve the goal of both protecting small businesses and improving access to affordable credit for small businesses. The regulatory response should also be based on the tenure of the lending category, lender and asset class as well as the scale and impact of the unfair term.

The proposal, if introduced, would enable regulators to exercise a blanket power across an entire class of small businesses, without regard to these factors. Further, the power is a blanket allocation of government resources to small businesses to claim damages and other orders with respect to a contractual term. The same allocation of government resources is not afforded to the other parties to the contract. The heavier allocation of government resources to the small business party may be a disproportionate response, depending on the circumstances.

C. There are sufficient avenues to enforce the unfair contract terms protections, under current laws

In our view, there are sufficient avenues available to regulators to enforce unfair contract term protections under current laws. Further, and with the exception of the gaps highlighted in our response to question 10 above, there are sufficient avenues available to small businesses to remedy unfair terms.

Protections against unfair contract terms can currently be enforced through the courts, as follows:

- ASIC has the power to commence court proceedings to enforce unfair contract term protections;
- Individual small businesses can commence court proceedings on the basis that a term is unfair; and
- Small businesses can commence class actions on the basis that a term is unfair.

In addition to enforcement through the courts, small businesses that contract with credit providers and other financial service providers that are members of the Australian Financial Complaints Authority (AFCA) can make a complaint to AFCA on the basis that a term is unfair. We note that AFCA can make a binding decision that a financial services provider must compensate a complainant for direct financial loss. In relation to small business loans, the caps on compensation currently range between \$1 million to \$2 million. In some circumstances, there are no caps on compensation. Further, AFCA can publish its determinations.

D. The scope of the power is unduly broad and its key elements are undefined

Whilst we recommend that the proposed power not be introduced, we make the following comments with respect to its scope and nature.

The scope of the proposed power is broad

The scope of the proposed power is broad. It would include circumstances in which an unfair term is *likely* to cause (with no further test, for instance of reasonableness) a class of small businesses to suffer damage. For instance, if an unfair term is determined by a court to have caused loss or damage to single small business, it will likely pass the test of being likely to cause loss or damage to the entire class of similar small businesses.

The key elements of the proposed power are undefined

The key elements of the proposed power are undefined and unclear. It is unclear whether small businesses would need to proactively opt into being included in any court action (i.e. by opting to belong to a class of small businesses) or whether power would relate to a notional class (defined by the regulator). If the power relates to a notional class, then it is unclear how a regulator would define a “class of small businesses”. There is a wide range of possible approaches, including defining businesses by the nature of their business model, their target market or their industry.

The loss or damage that would be captured by the proposed power is also undefined. This creates uncertainty in the scope and nature of the power.

Kind regards,



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If you would like more information regarding our submission, please contact:

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