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   Stephen P. King, Productivity Commission and Monash University

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Introduction

Banking it is claimed is facing a period of disruption and uncertainty. Technological advances, it is argued will transform the industry and sweep away old institutions.

Alas, I am here to deliver the ‘damp squib’. Tonight it is my sad duty to say that the banking revolution is not around the corner. While there will be technological change that will improve services and benefit customers, this will be evolutionary not revolutionary.

In this talk I want to consider two of the potential drivers of technological disruption - Open Banking and the New Payments Platform.

Open banking

Australia’s Open Banking regime has elements in common with both the UK’s Open Banking regime and the new European Payments System Directive (PSD2). The key element of each is that banks are required to release information about a client’s accounts to either other financial institutions or to the client themselves, at the request of the client.

So how will the data freed up by open banking be used? Judging by overseas experience, an early application will be a mobile dashboard for consumers. If a customer has multiple financial products spread over different institutions a service provider will be able to bring this data together. The consumer will have a one-stop-app for their finances and budgeting.

Another early application is likely to be improved comparison tools. Consumers will have a better idea of what financial products they can access and at what price in real time.

However, will open banking actually make a difference to retail banking competition?

Will Open Banking enhance retail banking competition?

There has been a lot of work in economics on information and competition. Most of this work is not specific to banking. But it does suggest that open banking can have a real pro-competitive impact.

Why?

The basic idea is that customer specific information drives bespoke products and personalised pricing. If only one bank has a customer’s information, then they can offer a bespoke product. But they will do so at a high price.

How will rivals respond? As they lack the information for the bespoke product, the best they can do is offer a generic product and try to win on price. But that is not a great strategy. Indeed, in some situations, the best that rivals can do is give up. The information advantage is so important that each producer simply focusses on its existing customer base and there is little if any business stealing.

This is not a great outcome for consumers.

Now, introduce open banking reforms so that consumers can ensure that all potential providers have their relevant information. With information symmetry, producers can compete on both the bespoke product and the price. Competition moves into over-drive and consumers end up significantly better off.

There are a number of caveats to this result.

First, in some markets, such as insurance markets and lending markets that are subject to adverse selection, better information can make some customers better off but makes others worse off.

For example, if driver data is automatically collected by car companies but then passed on to insurers, good drivers will generally find they get offered better insurance at a lower price. But drivers revealed as poor risks by the data may find that their price of insurance rises.

Second, knowing that data can be shared will alter the incentives of banks to collect the data in the first place. For open banking, the focus is on account and transaction data. Financial institutions need this data to provide the relevant products so there is little risk that the data will not be collected. Importantly, open banking does not apply to value added data, where a bank has worked with customer data creating larger data sets that, for example, allow it to better manage its whole-of-business risk.

As the broader customer data right spreads, the clear distinction between customer data and value-added data must be maintained to avoid creating perverse incentives.

Of course, there is a trade-off. By limiting the scope of shared data, the competition benefits from reform may also be limited.

Third, in banking, regulation is significant and necessary for prudential stability. But this regulation may impede the type of bespoke products that open banking is designed to incentivise. To get the full benefits from open banking, regulations must be flexible enough to allow financial institutions to be innovative in their product offerings.

Open banking and SME Lending

As an example, let’s consider the interaction of open banking and lending to small and medium sized businesses.

It has been argued that Open Banking may have a big impact for small business: By enabling small businesses to provide relevant data currently held by one financial institution to other financial institutions the hope is that competition will be put on steroids. Rather than facing one informed lender and many uninformed competitors, the SME will face a range of lenders with the information they need to evaluate risk and provide finance.

Navaretti, et. al. think these potential benefits are overstated. In their view SME lending is “[c]hanneling of business credit is embedded in human interactions between the bank and the customer. Open banking, by focusing on the hard data, will not completely remove the information asymmetry between potential lenders. But it will help alternative lenders to better evaluate the SME and make competitive loan offers. It is better for the customer to be able to easily provide alternative lenders with access to at least the hard data, rather than no data.

It may be argued that this distinction between ‘hard’ and ‘soft’ data is over-rated; that most Australian banks gave up relational banking long ago. Maybe or maybe not. Others are better placed than I am to judge this. However, even if this claim is true today, it is unlikely to hold true in the future. With open banking, the ‘soft’ information provided by ongoing customer relationships rather than ‘hard’ transferable data, is likely to be an incumbent bank’s point of difference. A bank that downgrades the value of relational information may find itself out-competed by those that value and invest in this soft data. In other words, open banking may see banks refocus on
the sort of soft data that is excluded from the open banking regime, in order to gain a competitive advantage.

The bottom line is that open banking will benefit SME’s compared to the status quo.

What about our third caveat, on system flexibility.

The extra information available to competitor banks through both open banking and other IT advances, will help banks better evaluate the risk associated with specific SME loans. Because information will be shared across banks, this should make it easier for SME’s to get loans that are appropriately priced to their level of risk. However, banks may be constrained in their ability to increase the level of nuanced SME lending if their capital costs cannot change to reflect these differences in risk.

As the Productivity Commission noted in its draft report on competition in the Australian financial system (2018, p18) “[a] single risk weight (of 100%) applies to all SME lending not secured by a residence, with no delineation allowed for the size of borrowing, the form of borrowing (term loan, line of credit or overdraft) or the risk profile of the SME borrowing the funds. In contrast, Basel proposed risk weights for SME lending vary from 15% for SME retail lending up to $1 million, to 150% for lending for land acquisition, development and constructions”.

Having an open banking system with the potential to provide information-based bespoke loan products to SMEs will have a diminished value if those banks face one-size fits all prudential regulation. So for open banking to bring its potential benefits to SME’s there needs to be a nuancing of prudential regulation.

What about the final caveat. Will open banking make all SME’s better off?

No!

Small business is often risky. New small businesses may have little information – hard or soft – that can be evaluated by lenders. Sometimes a well operating business will hit hard times. In some cases it can recover and information will help lenders support this recovery. In other cases, the SME will be terminal and the business should be wound up – despite potential protests from the owners. Our first caveat holds true. Open banking is not a panacea for poor business. It will enhance, not undermine, SME lending. But there will still be disappointed SMEs.

Interaction with overseas standards.

So, in my opinion, Open Banking will bring real benefits to customers. But it will be a big bang.

And there is a longer term question about whether individual country data rules, like our open banking rules, can survive over the longer term.

In Australia, open banking is the first application of the new Consumer Data Right. This right will “give consumers the right to safely access certain data about them held by businesses. They will also be able to direct this information be transferred to accredited, trusted third parties of their choice” (The Treasury, 2018, p1).

Applications of this right in energy, telecommunications and other sectors are expected in the future. Similarly, in the EU, there is the open banking reforms, PSD2, and a broader General Data Protection Regulation or GDPR – the equivalent of our consumer data rules.

Unlike Australia, however, these reforms have developed in parallel and it is not clear that they are consistent (Vezzoli, 2018).

It is clear, however, that there are inconsistencies between the Australian approach and the EU. For example, following the recommendations of both the Productivity Commission’s inquiry into Data availability and use (2017) and the Review into Open Banking by Scott Farrell (2017), the Australian approach to Open Banking does not give consumers a right to delete data on them that is held by a bank. In contrast, the GDPR has an explicit ‘right to erasure’ or ‘right to be forgotten’ in certain situations.

As different countries rule out their data regimes, these inconsistencies will grow. It is likely that regimes that are adopted by larger trading areas, such as the EU, and that are more conservative, will dominate. Businesses will not want to support multiple compliance systems. And they will not want to be isolated from large trading blocs.

In other areas where international standards are required for consistent operations of businesses in multiple jurisdictions, such as telecommunications, international standards bodies are established. At present, this seams a dim hope for data. The result may be a patch work of inconsistent international standards with the Australian open banking standards being largely usurped by more conservative overseas rules, such as the GDPR.

Payments and the cashless society.

The second potential driver of technological disruption that I want to briefly discuss is the new payments platform (NPP).

The NPP is a significant piece of infrastructure that allows close to real time transfers between accounts held by different individuals at different financial institutions.

But it is not the first such platform. The NPP follows – and has learnt from – the UK’s Faster Payments Service (launched in 2008), Sweden’s Swish mobile payments system (started 2012) and Singapore’s G3 system (started 2014).

So will the NPP and similar innovations overseas revolutionise payments, potentially leading to the demise of both cash and the traditional card businesses like Visa and MasterCard?

Will this lead to a cashless society?

Superficially, the potential for disruption to cash and traditional card payments seems strong.

For example, Ant Financial, with its Alipay system, in China, has developed the world’s largest mobile payments system. In 2003 it launched as an online payments system. In 2011 it went off-line, for general consumer payments. These payments can be initiated in two ways.

The first involves the payer generating a one-off QR code that is scanned by the merchant. The other is where the payer scans a QR code with the merchant’s banking details and uses this to transfer funds to the merchant.

Alipay can be linked to traditional debit and credit cards but can also use stored value. Its stored value capabilities are threatening traditional banks. Users have the option of having their funds in an Alipay e-wallet invested in an at-call money market fund and there are approximately 260m users of this service. In terms of transaction numbers, Alipay is larger than the main Chinese credit card system, UnionPay.

So is China the poster child for payment system disruption?

Certainly not for Australia.

Ant Financial expanded in a society that had been significantly underbanked and where interest rate controls made traditional bank accounts unattractive. Its rise is more market penetration than disruption.

So perhaps we need to look to a developed country for the payments revolution.

In Sweden, the success of the Swedish technology has coincided with a significant reduction in the use of cash. Swish was created by a consortium of seven Swedish banks in cooperation with the central bank of Sweden and operates via a simple phone-based application. It enables real-time transfers in Swedish Krona between Swedish banks. There are no fees for individuals, as there are for per transaction fees for businesses (approximately 2SEK or AUD0.30 with no surcharging). It uses a PayID system – so that transfers can be made to a person just by knowing that person’s phone number.

So Swedish sounds a lot like the NPP. And the success of Swish has led to claims that Swish is moving to be a ‘cashless’ society.

“So Sweden is one of the most cash-less societies in the world, and many shops, restaurants and even bank branches refuse to accept cash payments. In just over 10 years Swish have reduced its cash in circulation to 50 billion Swedish crowns ($6.14 billion) from 12 billion” (Reuters, 2018).

However, while the statistics show increasing use of Swish, it is largely for person-to-person transactions not person-to-business. So while Swedish and debit cards are both driving down the use of cash, they are impacting different transactions:

“Card payments using debit cards retain their position as favourite among Swedish households. This year, 80 per cent state that they paid by debit card for their most recent purchase, 72 per cent that they used cash and 7 per cent that they used a credit card. Purchases regarding sums under SEK 100 also occur increasingly with debit card. Mobile payments...”
such as Swish are still used to a very limited extent for "purchases in an actual shop" (Sveriges Riksbank, 2018, p.4).

In other words, traditional card payments are driving down the use of cash. Swish payments are a small part of the story.

The experience with the FPS in the UK has been less impressive than Swish, but reflects similar factors with growth in both debit cards and FPPS occurring at the expense of cash.

When commenting on the UK experience, and its applicability to the US, Greene et al. (2015, p.28) note that “Overall, from a consumer perspective, it appears that consumers in retail settings in the United Kingdom and the United States have good options for fast payments. Debit and credit transactions appear immediately, and cash is often an option. Merchants may see this differently, as their payment may be delayed. But consumers tend to be the driving decision-makers in retail settings, and they have little reason to adopt new technology, even if incentives change, for example if merchants were to choose to offer discounts. However, person-to-person transactions are different.”

Based on overseas experience, the NPP is unlikely to drive us rapidly towards a cashless society. It can, however, be so. However, since 2003, the Payments System Board has played a game of regulatory whack-a-mole with the card companies and banks. Regulation has been put in place on interchange fees and surcharging. However, this regulation has led to circumvention and further regulation. As a simple example, three party schemes such as American Express were able to avoid the original interchange fee regulation. They do not have an interchange fee. This resulted in banks issuing American Express companion cards that could avoid the regulation. The result - American Express rapidly increased its market share in card payments and the RBA had to modify the regulations to close this loophole.

While the new regulations came into effect in July last year, it is already clear that banks are considering ways to circumvent them. For example, in January this year, Westpac announced that it had the ability to issue Visa cards which would be issued American Express, avoiding the revised card restrictions.

Rod McDougall and I suggested an alternative regulatory approach in a recent (2017) ACFS working paper – a “customer pays” approach. Regardless, there needs to be a review of the current approach to card regulations to ensure that the regulations are sustainable.

Can the NPP facilitate payments innovation?

The second lesson is that if the new payments platform is to be a vehicle for disruption in payments, it needs to be accessible by innovators, not simply the existing banks. While Swish has been the most successful new payments platform, it is still dominated by the traditional banks and its services reflect this dominance. The FPS in the UK, together with the UK open banking regime, seems to be attracting more payments innovation, but this has had little impact on the parts of the financial system, such as the prudential rules for dedicated payments providers and their access to exchange settlement accounts at the Bank of England. It is too early to tell if these innovations will be true disruptors. However, if we want innovation and disruption to have a chance in Australia then we need a clear access regime for the NPP and we may need changes to other regulations.

If you want a cashless society look to the under-banked

Third, it should not be a surprise that disruptions to cash payments and the development of alternatives to cash and traditional card-based payments are occurring in developing countries. The banking systems in these countries are often poor and many people have little access to banking services. In such situations, alternatives can thrive. These countries, such as China, Kenya and India, will leapfrog the technology of developed countries like Australia.

That said, the new payment instruments developed in these countries will raise the same old prudential issues. For example, while Alipay’s e-wallet is a popular deposit account in China, it also largely falls outside the prudential net.

“However, as an increasing number of depositors move their money from bank accounts to fintech e-wallets … they will no longer be entitled to the official protection over their money. Most depositors do not realize this potential risk…” (Lu, 2018, p.42).

In the longer term, Alipay may become China’s “too big to fail”.

So, where does this leave Australia. The NPP will change payments. It needs to be open for innovators. But any change is likely to be evolutionary not revolutionary. The payments revolutions will come from developing countries – at least until something goes wrong.

Competition and the role of Fintechs

My comments so far will be a disappointment to the boosters of fintech. In the two areas I have considered I don’t see a revolution coming anytime soon.

Both open banking and the NPP are important reforms. They will benefit consumers and the Australian economy. But in my opinion, they are unlikely to be disruptive reforms. More broadly, financial innovation, both in Australia and globally, is nothing new. It goes back to at least the period of deregulation in the 1980s. Some of these innovations have been significant:

For example:

• The advent of securitised mortgage lending in the 1990s in Australia, which significantly increased competition in the home loan market; and
• The growth of index funds and exchange traded funds, which have significantly increased the ability of small investors to access equity investments at low cost.

However, most fintechs will aim to co-operate with the existing financial institutions, not disrupt them. They will aim to be taken over and have their technology incorporated into the product offerings of incumbents. There may be exceptions at the margin, for example in payments. But do not look to the fintech sector to disrupt Australia’s current banking oligopoly.

So for banking, the uncertainty will continue. But much of the uncertainty will revolve around regulation and product evolution not external disruption.
The Demise in the Craft of SME Banking.

Joseph Healy, CEO Judo Capital
THE DEMISE IN THE CRAFT OF SME BANKING

This paper argues that there has been a market failure in the provision of bank debt to the small-to-medium-sized-enterprise (SME) sector. Linked to this market failure has been the demise in the craft of SME Banking, a competency which is progressively being lost to the Australian economy. This loss is not analogous to the demise of the blacksmith threatened by the advent of the motor vehicle; this is a loss of a craft central to how a nations SMEs flourish. It is akin to the loss of the local GP to online self-help medical advice, which may diagnose routine symptoms but lacks personal knowledge to diagnose serious issues, or to take early steps if things deteriorate. Extending this analogy, many SMEs decide not to seek advice because of a lack of trust in this impersonal approach.

Overview

At the core of this argument is the belief that a nation’s financial system is central to its economic prosperity. The nature of that financial system, particularly its banking system, matters. Banks are different from normal businesses. A concentrated banking system protected by a public policy framework and implicitly subject to a government guarantee, is a banking system that is granted special privileges and with those privileges comes obligations and responsibilities to society. In a corporate governance sense, this goes to the heart of purpose – why the banking firm exists. This is an important theory of the banking market. Post Basel II, coinciding with an ‘industrialisation’ of the operating models within banks, including credit decisioning, a significant operational and cultural shift took place in the way that banks operated, which has had a material impact on SMEs. Six inter-related factors explain this systemic shift:

(i) largely driven by ROE based performance incentives, there has been a bias towards lower capital risk weighted household mortgage lending (currently at an eye-watering $1.6bn up from $280bn in 2000), growing at -3.5x GDP, whilst, SME lending through the banking system (currently at a stock of ~$250bn) has barely grown as a share of GDP since the GFC. This compares to a long-term growth in SME bank credit at an average of 1.8x GDP pa. In 2000, every $1000 of home lending was matched by $1000 in SME lending. By 2017, every $1000 in home lending was matched by $130 in SME lending.

(ii) given the largely commoditised nature of household lending, a largely oligopoly-structured market has sought to build greater economies of scale, in a drive to further increase the high economic rents already earned.

(iii) banks have ‘industrialised’ their operating model with a significant undermined in customer facing personnel as relationship banking has been devalued and banking ‘dehumanised.’

(iv) a largely ‘one-size-fits-all’ approach to SME lending evolved from these changes which has seen property-based security (collateral) dominate in the 4Cs (character, capacity or cash flow, capital and collateral) of credit decisioning.

(v) the emergence of an aggressive sales culture that has prioritised product sales over customer needs.

(vi) a decline in the craft of relationship banking and credit decisioning in SME banking, is linked to the progressive decline in professionalism within the industry. Credit risk management skills, once seen as a core competency of any banker and a critical condition of career progress, are no longer viewed that way.

Methodology

This decline in professionalism can be understood by the prevailing underlying culture that has become deeply rooted within the industry where there is no professional or professional accreditation needed to practice as a banker and in many parts of the industry, a proliferation of mid-career hires from other professions and particularly from management consulting. These talented professionals came with no practical knowledge of or training in banking. They enjoyed the intellectual challenge of complex organisations and the potential in the ‘financialization’ of the economy. This financialization of the economy and conglomerate nature of the banking model coincided with the decline in traditionally trained bankers and the decline in professionalism in banking (or what it meant to be a banker). The financialization of the sector manifested itself in many forms, including a bias towards selling and cross-selling products as banks are charged with making sure that customers support the economics of the conglomerate nature of the firm. Many of the new breed of bank executives had no technical or intuitive skill in understanding risk management. One aspect of this de-professionalisation of banking, has been a breakdown in the risk culture, and with the emergence of a ‘sales culture’ system failures such as evidenced by the level of ‘ liar loans.’ The decline in professional standards is also evident in the many ethical and conduct issues that have plagued the banks. These cultural issues have been highlighted by the Royal Commission and by widespread customer and societal dissatisfaction with banks.

No sector has suffered more from the industrialisation of the banks and the decline in professional standards than SMEs, who heavily rely on the banks for access to capital, cash management and risk management services. The paucity of the service proposition to SMEs has benefited the broker market which is increasingly disintermediating banks. Brokers now account for ~30% of all new SME loans. This trend (disintermediation) has only had limited benefits to SMEs however as the banking market is concentrated and lacking in meaningful competition. The major banks have a stranglehold on the market and are largely unfragmented in nature. One former bank director observed – “There is a huge sameness about our banks… you could switch the brand names of our banks and no one would know the difference. It is very incestuous.”

The Australian commercial banking is a powerful oligopoly industry, protected by special privileges, allowing the major banks can earn well above their risk-adjusted cost of capital. The trust deficit that has emerged has resulted from an abuse of the privileged position. As with any social licence, there is an expectation that banks will also be guided by the interests of the community when allocating and monitoring credit rather than just that of maximising shareholder value. A fundamental reason why the changes to the way the banks operate has impacted SMEs more than any other segment, is because SME banking must deal with the problem of an information inefficient market, unlike retail or large corporate banking. To deal with this asymmetric information problem banks have largely insisted on real estate security rather than deal with the transaction costs of having bankers close to the customer and able to apply judgement on all the 4Cs of credit decisioning. Whilst this approach to SME banking has served the banks well, it has failed their customers. It has resulted in a significant credit gap in the SME sector which Macquarie Bank have estimated to be ~$70bn. This could be viewed as a form of market failure, which is one reason why some experts believe SME financing should be a public policy matter and has resulted in others suggesting that a state sponsored Business Bank is established as has happened in the UK. In the absence of meaningful competition, the banks have leveraged their power to maximise profits, and everything else is secondary.

The economic opportunity cost of how the banks allocate capital is difficult to estimate but the relation between economic growth and SME access to finance is well established. That there is an issue in financing Australian SMEs and that there are associated economic costs has been acknowledged by the Reserve Bank of Australia (RBA).

The composition of a nation’s financial system matters and the role that the banking system plays in allocating and monitoring credit is central to the economy. A bank}

1. SMEs are defined for the purposes of this paper as businesses with turnover up to $20m pa.
2. Australian household debt is ~200% of disposable income, with total household liabilities $2.466bn, representing one of the highest indebted household sectors in the world. www.businessinsider.com.au 18/01/2018
3. Six inter-related factors explain this systemic shift:
4. One aspect of this de-professionalisation of banking, has been a breakdown in the risk culture, and with the emergence of a ‘sales culture’ system failures such as evidenced by the level of ‘ liar loans.’ The decline in professional standards is also evident in the many ethical and conduct issues that have plagued the banks. These cultural issues have been highlighted by the Royal Commission and by widespread customer and societal dissatisfaction with banks.
5. SMEs have ‘industrialised’ their operating model with a significant undermined in customer facing personnel as relationship banking has been devalued and banking ‘dehumanised.’
6. A largely ‘one-size-fits-all’ approach to SME lending evolved from these changes which has seen property-based security (collateral) dominate in the 4Cs (character, capacity or cash flow, capital and collateral) of credit decisioning.
7. The financialization of the economy and conglomerate nature of the banking model coincided with the decline in traditionally trained bankers and the decline in professionalism in banking (or what it meant to be a banker). The financialization of the sector manifested itself in many forms, including a bias towards selling and cross-selling products as banks are charged with making sure that customers support the economics of the conglomerate nature of the firm. Many of the new breed of bank executives had no technical or intuitive skill in understanding risk management. One aspect of this de-professionalisation of banking, has been a breakdown in the risk culture, and with the emergence of a ‘sales culture’ system failures such as evidenced by the level of ‘ liar loans.’
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The Demise in the Craft of SME Banking - cont

ing system that has a bias to allocating scarce funding to the household sector because of capital risk weighting advantages which are fundamentally linked to remuneration incentives and that has lost the skills to lend to the SME sector, builds up costs and risks that eventually will become apparent. There is an argument that the Australian banking system, sometimes described as a ‘building society system’, is susceptible to this risk.

The economic opportunity cost of how the banks allocate capital is difficult to estimate but the relation between economic growth and SME access to finance is well established. That there is an issue in financing Australian SMEs and that there are associated economic costs has been acknowledged by the Reserve Bank of Australia (RBA). The composition of a nation’s financial system matters and the role that the banking system plays in allocating and monitoring credit is central to the economy. A banking system that has a bias to allocating scarce funding to the household sector because of capital risk weighting advantages which are fundamentally linked to remuneration incentives and that has lost the skills to lend to the SME sector, builds up costs and risks that eventually will become apparent. There is an argument that the Australian banking system, sometimes described as a ‘building society system’, is susceptible to this risk.

Banking System Overview

Australian banks have profited from a relatively insulated, largely domestic oligopoly. In 2017/18, the four major Australian banks made profits totalling more than $3.4 billion in a market of just 28 million (including New Zealand). These major banks dominate SME lending with ~85% market share, a position boosted by post-GFC market consolidation.

There is no banking system anywhere in the developed world that earns such high economic rents because as former Treasurer Peter Costello succinctly stated “Our banks are absolutely immune from market discipline, living in a highly profitable cocoon; they think all these high returns are from their own brilliance, but what they haven’t understood is they have a unique and privileged regulatory system which has delivered this to them”.

A Bias to Household Lending

Amongst Anglo-American economies, a unique characteristic of the Australian financial market is the dominance of the banking system, and the relatively limited fixed income market. The banking system has progressively since the GFC, exhibited a strong bias to household lending predominantly in the owner-occupied market, but increasingly in the higher risk investor market (buy-to-let), which accounts for ~30% of all household lending. This bias, which plays to the one-size-fits-all industrialised business models of the banks has resulted in one of the world’s most highly leveraged household sectors.

Statistics from MoneyQuest Finance Specialists on the experience of SMEs seeking finance found that only 41% are approved. This leaves just under 22.5% of enquiries resulting in an extension of credit. Evidence of this can be found in the centralisation of credit decision-making, the continued ‘thinning’ of banker coverage, the centralisation of customers into call centres, the increasing application of technology, and the introduction of ‘one-size-fits-all’ policies in the quest for standardization, all of which are fundamentally aimed at achieving economies of scale and lower cost-to-income ratios. This has however resulted in a ‘dehumanising’ of the customer service proposition, which has impacted the level of investor-based lending adds to nature of this risk).

The Basel II motivated bias of the Australian banks to household mortgage lending, creates a distortion in the system toward household lending relative to business lending. This was a rational response by individual banks given relative ROEs, but arguably irrational for the economy or the risk profile of the system as it can create asset bubbles which can have significant systemic ramifications in the event of a pricing correction (the level of investor-based lending adds to nature of this risk).

There is a growing body of research suggesting that as banks grow, and one-stop-shop financial service conglomerates created, that the fundamentals of banking have shifted away from the customer.

Evidence of this can be found in the centralisation of credit decision-making, the continued ‘thinning’ of banker coverage, the centralisation of customers into call centres, the increasing application of technology, and the introduction of ‘one-size-fits-all’ policies in the quest for standardization, all of which are fundamentally aimed at achieving economies of scale and lower cost-to-income ratios. This has however resulted in a ‘dehumanising’ of the customer service proposition, which has impacted SMEs more than any other customer segment.

Statistics from MoneyQuest Finance Specialists on the experience of SMEs seeking finance found that 46% of enquiries do not go further than an initial conversation and of the 54% that are considered, only 41% are approved. This leaves just under 22.5% of enquiries resulting in an extension of credit. The rate of early rejection reflects the conservative credit appetite of the banks, the preference for a one-size-fits-all approach and the insistence of real estate security. What these statistics don’t measure is the decision by SMEs not to pursue credit for investment purposes given their perception of the challenges involved. A similar picture is evident in the UK. Data on loan application rates shows a continuing decline in the share of SMEs seeking new loans to 1.7% of smaller businesses. Only 43% of UK SMEs are confident that they will get a bank loan, and attitudes against borrowing are becoming entrenched.
THE DEMISE IN THE CRAFT OF SME BANKING - cont

The internal process and efficiency drive within banks has made it more difficult to provide credit facilities where credit information is more "informationally opaque" (i.e. not based on clear, quantitative data). The emphasis on 'hard information' has weakened the weighting given to judgment, and in doing so, has weakened the essence of relationship banking, particularly in the SME sector. This has been exacerbated by the de-skilling, loss of experience and lack of professional training and qualifications (particularly around credit risk management) in what it means to be a "banker." The 'dehumanisation' of SME banking is further underscored by the decision of several banks to remove relationship management coverage for SME exposures <$1m and centralise the management of these customers through call-centre style platforms. Even with SMEs that remain part of the relationship management proposition, they tend to be covered by a banker with a portfolio of as many as 200 customers - double the level of pre-GFC, so the quality of that relationship proposition suffers accordingly.

Adding to the challenges faced by SMEs, is the dominant culture within major banks, evident in the language of "selling products," as highlighted in the Royal Commission deliberations. One former employee of major bank summed this up: "It was all about the sale, not about the customer, and all about targets, statistics and increasing revenue." Core skills have become significantly devalued over decades as banks have placed greater emphasis on "product sales," with fewer senior executive role models, trained in the fundamentals of banking. In some professions, "selling" has a negative connotation, particularly where there is a relationship based on trust, which is how banking was once defined - credit from the Latin creditum is "to trust, entrust, believe". Would you want your dentist or doctor, for example, to "sell" you more treatment than you need?

The retail emphasis in banking has created a deeply ingrained sales culture. Consistent with a view that the FinTech model and big data holds the solution to this market failure, much is made of digitalisation and artificial intelligence (AI) in the way banks should think about SME banking. This perspective was underpinned in a survey of senior executives in the US by EY, where 81% of executives said that: "data should be at the heart of all decision-making", which lead the authors to proclaim that, "big data can eliminate the reliance on 'gut feel' decision-making". This emphasis on quantitative data prevails in the minds of many bank executives as they think about the "cost-to-deliver" SME banking. What this scientific approach fails to capture is the quality of character, ambition, concerns, need for advice, succession planning, plans to acquire, innovate and grow. What happens, absent informed human intervention (relationship banking), when the SME hits a difficult patch or requires understanding and support in navigating major transitional events? A science driven approach to SME banking has its role but it also has its limitations. Behavioural science has taught us much in the field of economic finances to know that human judgment matters particularly in information inefficient markets where asymmetry problems can be the norm rather than the exception.

Concluding Remarks

The demise in the craft of SME banking can be linked to a cultural shift in the banks progressively since Basel II, which coincided with the banks "industrialising" their operations in ways that dehumanised the relationship proposition to the customer in the pursuit of greater levels of profitability.

This saw a progressive decline in SME relationship banking skills, professionalism more broadly and the demise of the craft of SME banking, particularly in SME credit assessment using the 4C framework. The financing of SMEs is much more than reviewing numbers; it relies heavily on the judgement of the personality, reputation and capabilities of the individuals running the business. This is not something that readily lends itself to automation or to distance-based assessment.

Banking is not just like any other business. The relation of an economy's financial system to its savings and investment decisions is very important, especially the role that the banking system performs as allocators and monitors of capital. The bias in the Australian banking market towards household lending and the credit gap that exists in the SME market, are evidence of market failure, which requires a public policy intervention. Major banks, which are granted special privileges, need to be reminded of their social licence obligations.

OPEN FOR BETTER - APPLYING OPEN BANKING TO SMALL BUSINESS BANKING

Scott Farrell, Partner, King & Wood Mallesons

3.

OPEN FOR BETTER - APPLYING OPEN BANKING TO SMALL BUSINESS BANKING

BY SCOTT FARRELL, PARTNER, KING & WOOD MALLESONS

Introduction

Open Banking is not a term of art. It can mean different things in different places and to different people. In Australia, Open Banking is a framework designed to give customers a right to direct that the information they already share with their bank be safely shared with others they trust. It is intended to give customers more control over their information, leading to more choice in their banking and more convenience in managing their money, and resulting in more confidence in the use of an asset mostly undiscovered by those customers—their data.

In Australia, Open Banking is to be the first part of the Consumer Data Right, a more general right being created for consumers to control their data, including who can have it and who can use it. Banking is the first sector of the Australian economy to which this right is to be applied and more sectors of the economy are to follow, including energy and telecommunications. Open Banking is to work together with the application of the Consumer Data Right in other sectors to form a single, broader framework.

Starting with banking makes sense because of the firm foundation of principles provided by the duties that a bank owes its customer. A bank has a duty to keep a customer’s money safe and to pay it to others at the customer’s direction. Also, a bank has a duty to keep its customer’s information confidential. So, a similar obligation for a bank to provide the customer’s information to others at the customer’s direction makes sense—both money and information are valuable and the bank would not have either without the customer. In this way, the long-established banker-customer relationship can help guide Open Banking’s construction and once the framework is built, it can be extended to other sectors.

Of course, there is much more to Open Banking (and the Consumer Data Right) than extending the banker-customer relationship. However, four design principles have emerged and been adopted to guide the development in Australia:

OPEN BANKING SHOULD BE:

<table>
<thead>
<tr>
<th>CUSTOMER FOCUSED</th>
<th>ENCOURAGE COMPETITION</th>
<th>CREATE OPPORTUNITIES</th>
<th>EFFICIENT AND FAIR</th>
</tr>
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<tbody>
<tr>
<td>It should be for the customer, about the customer, and seen from the customer’s perspective.</td>
<td>It should be done to increase competition for the banking products and services available to customers so that customers can make better choices.</td>
<td>It should provide a framework on which new ideas and business can emerge and grow, establishing a vibrant and creative data industry.</td>
<td>It should be efficient with security and privacy in mind, so that it is sustainable and fair, without being more complex or costly than needed.</td>
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These principles of how Open Banking should be should, why it should be done, what it should do and how it should be achieved, serve as an architecture to consider the implications of Open Banking for small business customers.

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1. The Author led the Australian Government’s review into Open Banking conducted in 2017. However, the paper is not written in any official capacity and the views expressed should be taken to be the author’s own.

2. All references to the implementation of Open Banking and the Consumer Data Right in Australia in this paper are taken from the Report of the Australian Government’s Review into Open Banking published in February 2018 and the subsequent announcements of the Australian Government to implement the recommendations made in that Report.
OPEN FOR BETTER - APPLYING OPEN BANKING TO SMALL BUSINESS BANKING - cont

CUSTOMERS

including small business customers in Open Banking.

The customers who will be able to take advantage of Open Banking in Australia are not limited to individuals. Businesses, including small businesses, will also be included. This is important because of the accretions of information asymmetries for small businesses, which can lead to higher cost and lower availability of credit.

The Open Banking Review found that smaller businesses typically have less documentation and shorter financial histories, so it is generally harder and more costly for competing providers to acquire the required information to make an assessment of potential small business customers. A bank that has an established relationship with a small business is at a significant advantage over its competitors in the supply of data-related services.

It has been argued that recent innovations in the small business lending market negate the need for Open Banking to be available and small businesses and that banks already have data available to small business customers through accounting software providers. However, these alternative means of accessing data are not as customer-centric as Open Banking and the Open Banking Review was not persuaded to exclude small business from Open Banking, particularly given its basis as a broad customer-centric right.

The decision to include small businesses in Open Banking would normally give rise to a need to define what a small business might be, and the Australian legal framework could not be said to be lacking when it comes to definitions of small business used for regulatory purposes. They are many, varied and not entirely consistent. Australia’s Open Banking framework avoids the need to consider this complexity by adopting a different basis for inclusion of customers in Open Banking - by reference to the accounts which the customer holds, rather than by reference to the customer who holds the account.

Open Banking is to apply to all customers holding the relevant accounts in Australia, whether individual or business, and whether big or small. These accounts to which Open Banking is to apply include many which are a fundamental part of a small business’s financial arrangements, including current accounts, cheque accounts, transaction accounts, GST and tax accounts, cash management accounts, trust accounts, farm management accounts, foreign currency accounts, business finance accounts, business lines of credit, business overdrafts as well as credit and charge cards accounts for business. A small business that holds one or more of these accounts in Australia with an Authorised Deposit-taking Institution, other than a local branch of a foreign bank (for convenience, such an ADI is referred to as a bank in this paper) is to be entitled to require its bank to share its data with another accredited entity.

It is important to understand the types of data relating to a small business customer that a bank can be required to share.

- Customer-provided Data: Data which the customer has provided to its bank, including information by themselves, on their financial situation and information needed for making payments.
- Transaction Data: Data which is generated as a result of transactions made on the customer’s account or service, including records of deposits and withdrawals, account balances, fees and charges, and interest earned and paid.
- Interest and related income: Data which the customer has derived from a loan and other financial services.

Also, Open Banking is to apply to product data which banks are under existing obligations to publicly disclose, which is intended to enable efficient analysis and comparison of the terms of these products.

Open Banking does not apply to value-added customer data, such as data that results from the bank’s efforts to gain insights about a customer, or aggregated data sets created when banks use multiple customers’ data to produce de-identified, collective or averaged data sets.

In summary, Open Banking is to include small business customers by giving them the right to direct their bank to on-share the data which they have provided to their bank, and their transaction data with other entities that the small business has chosen to trust with that data. This makes it important to consider who those entities could be, and why a small business would choose to share its information.

CHOICE

- encouraging competition for small business banking

The Reserve Bank of Australia has found that the market for small business loans, for example, has more structural impediments to competition than most other lending markets because the information asymmetries tend to be more significant.

Banks have to invest resources to acquire sufficient information to make a well-informed lending decision, which increases the cost of assessing and approving a loan application. When lenders are unable to access sufficient information to make a proper assessment, the risks associated with the loan are generally, and justifiably, perceived to be greater. This leads to higher provisioning and higher loan costs for the borrower.

Open Banking is intended to significantly expand the menu of potential services available to small businesses, including services related to the provision of credit, and to lead to better tailoring of products to their needs. That, in turn, should empower small businesses to seek out better deals at more competitive prices.

There are a number of important components in Open Banking which are needed to support this objective. The first is accreditation. This is the process that determines with whom a small business customer could direct its bank to share data. Under Open Banking, the data may only be shared with other accredited entities. Australian banks are automatically accredited, and for other entities (such as fintech companies and data intermediaries) a graduated, risk-based accreditation standard is to be used. This model is to have regard to existing licensing regimes and the criteria is to be determined by the Australian Competition and Consumer Commission (the ACCC is to be the lead regulator under Open Banking and the Consumer Data Right). The graduated risk-based approach is intended to avoid the need to impose high standards for participation when those standards are not warranted due to the limited information held, or the way in which it is held.

The second part is reciprocity. Not only are banks subject to a customer’s request to direct its data to another accredited entity, but each other accredited entity is also subject to directions from its customers too. This applies to data already provided to them under Open Banking, plus other customer-provided data and transaction data held by the accredited entity for the customer. For example, the small business customer could require not only that its bank share the customer’s information with an accredited fintech, but also that the accredited fintech share the customer’s information with the bank. This puts the customer at the heart of a data ecosystem built around its information and its requests for the sharing of that information. It also improves the contestability of the customer’s business, as a bank who is required to transfer customer information to another bank can benefit from a similar request made of the recipient if the bank improves the services which it provides the customer.

The third part is cost. The transfer of data under Open Banking is to be made free of charge to the customer. This is consistent with the thinking explained at the start of this paper, that an ability to direct that information shared between bank and customer be shared with another that the customer chooses should be regarded as an extension of the customer banker-customer relationship, rather than an add-on service for which there is a separate charge. There is some economic analysis of this in the Report of the Open Banking Review.

These three parts are intended to assist in remedying the information asymmetry which has been identified with small business lending - giving small business customers an avenue for testing whether the products and services which they are being offered by their bank are in fact the best for them. The provision of this information to alternative providers of these services is intended to harness transparency and business incentives for the customer’s benefit. One example of this is if a competing lender feels unable to offer a customer competitive pricing because it just doesn’t have enough validated information to assess the viability of a prospective customer’s business. The ability to request the transaction information of the
OPEN FOR BETTER - APPLYING OPEN BANKING TO SMALL BUSINESS BANKING - cont

prospective customer directly from the customer’s existing bank should enhance the information available to that competing lender in volume, reliability and granularity.

CONVENIENCE
- new banking services for small business through Open Banking

Like the other parts of Open Banking, the method of transferring information is to be customer-focussed. Most transfers are likely to take place using mobile or online technology based on technological standards set by a newly established Data Standards Body. The intent is to minimise unnecessary friction for the customer, whilst also providing the customer with safeguards, so that the transfer of information for Open Banking can be user-friendly. Even this could provide significant benefits to small business customers, as it should mean that they do not need to visit the bank branch with a bundle of papers to provide the financial performance of their business.

This standardised technology basis provides opportunities for services to be created for small business customers which are beyond comparison services for competition purposes. Two examples of this are account aggregation and data analytic services. Small businesses may have multiple accounts with multiple banks. Open Banking allows all of the data relating to the multiple accounts to be shared with one provider who provides a single “window” into the small businesses finances. This may seem like a simple service, but most small businesses are low on resources and any time-saving counts. Also, the ability to aggregate finances in one place removes one impediment to using multiple, competing service providers – being the complication of having multiple banking systems to navigate. Another example of the potential benefits of Open Banking to small business is its use to better inform them of their own operations. Small businesses have little access to the data analytics available to large businesses to assess the trends in their sector and own customer base. This sort of support should be more available to small businesses once there is a safe and easy way of transferring their transaction data (which reveals much about their business) to data specialists that are accredited for Open Banking. Those data specialists could be banks themselves. However, provided that they meet the accreditation criteria, the providers of these services need not be financial services providers, indeed they may be existing participants in the data industry.

As Open Banking and the Consumer Data Right progresses it should connect more customers, data holders and data recipients. All of these would be linked by their participation in a system which has shared rules and standards under which customer data and new and existing services and products are provided and exchanged. The foundation of the system is customers, as they will have relationships with both data holders and data recipients. From a customer perspective, the ability to provide their data that is held by one service provider (like their bank) to another in a completely different sector (like their telecommunications provider) could enable an entirely new field of products and services to be offered, enhancing choice and convenience. This should allow suppliers to small businesses to be even more customer-centric in the services they provide.

CONFIDENCE
- the safeguards to protect small business using Open Banking

Customer confidence is critical to the success of Open Banking. Customers need to trust that the right safeguards are put in place to ensure that their choice and convenience does not come at the cost of their rights to confidentiality. Customers also need to be confident that Open Banking is focused on giving them control of their data, that data recipients will take appropriate security measures to protect that data and that there are remedies available for losses that may be suffered. This applies to small business customers just as much as it does to individuals.

Australia’s Open Banking framework has a range of safeguards built in by design and available to small business customers. These include:

• The accreditation system briefly described above, which means that a small business’s data can be received under Open Banking only by those who meet the security standards required for that data. Also, it means that the recipients of that data are subject to Australia’s privacy and confidentiality laws and subject to the jurisdiction of Australian regulators.
• The regulatory system for Open Banking, which is based on a multiple regulator model, led by the Australian Competition and Consumer Commission. The ACCC is to be primarily responsible for competition and consumer issues, as well as standard-setting. The Office of the Australian Information Commissioner is to be responsible for privacy protection.
• The consent requirements for use of information provided under Open Banking, which are an enhancement over the current requirements under Australian law. Not only is data only shared when the customer has given an explicit direction to do so, but informed, and explicit consent of the customer is required for the use of that information when it has been shared. Also, notifications to customers of the implications of sharing data, including the use to which the recipient is applying the customer’s data, should be clear and concise.
• The dispute resolution mechanisms added for small businesses in Open Banking. The mechanisms for dispute resolution in the Australian Privacy Act are only available for disputes relating to personal information. For other breaches of confidence, the primary resolution mechanism available to small businesses is likely to be the courts. However, small businesses are likely to be financially constrained from taking their disputes through the court system. Accordingly, the Open Banking framework is to provide small business customers with similar access to alternative dispute resolution services for confidentiality disputes as exist for disputes relating to personal information under the Privacy Act.

These, and the other safeguards which are to be part of Open Banking offer a better framework for small business to share their data with confidence.

CONCLUSION:
- giving small business more choice, convenience and confidence

Open Banking is designed to make it easier for small businesses to share their banking information with others they trust. They may choose to share their information with others to obtain better priced or better quality banking services, to better understand their finances or to better comprehend their own business or their own customers. Australia’s Open Banking framework is not designed to make the choices for small businesses as to what they should be using their information for. Instead it is designed to provide a safe and effective means to empower small businesses to make their own decisions. Hopefully, this will mean that small businesses can start to share in the value of their banking data, and harness it for the benefit of their business.
DEVELOPMENTS IN CORPORATE DEBT CAPITAL MARKETS: BOND FUNDING OPPORTUNITIES EVOLVE FOR AUSTRALIAN CORPORATES.

Brad Scott, Director, Debt Capital Market Originations, National Australia Bank July 2018

SECTION 1

Favourable Global Market Backdrop in Recent Years

A fundamental cornerstone of advanced financial systems is the existence of efficiently functioning debt capital markets to ensure the cost effective sourcing of funding and credit². This has certainly been Australia’s experience in recent years where conducive global financial conditions have cultivated a widening array of favourable debt capital market funding sources for corporate and financial issuers.

While on a smaller absolute scale relative to deep Northern Hemisphere markets, this trend reflects the wider gravitas of debt capital markets generally experienced amongst domestic corporate issuers since the Global Financial Crisis (“GFC”). On a broader scale, this trend is most obvious by the 2.6x increase in global non-financial corporate bond issuance over the past decade to >US$2 trillion in 2017³. With the domestic equivalent metric similar over the same time period, this success can be attributed to both local and international bond market growth, noting that Australian corporates rely heavily on both sources, and notably offshore capital pools⁴.

Footnotes:
1. In this paper, references to Corporates refer to ‘Non-financial issuers’ but include real estate investment trusts.
3. Rising Corporate Debt: Peril or Promise?, McKinsey Global Institute, June 2018
4. For a historic perspective on why this is the case, see Battelino, R. ‘Why do so Many Australian Borrowers Issue Bonds Offshore?’, Reserve Bank of Australia, ABA Banking; speech to Australian Bond Forum (2002)

SECTION 2

Recent Strong Fixed Income Funding Outcomes Corporates Achieved, and the Rise of Socially Responsible Investment; Importance of Asian Investors; Widening Appeal of A$ Corporate Bonds and Growth in Institutional Term Loans.

SECTION 3

Tailwinds and Challenges Corporate Issuers Face in Global Markets; and the Importance of Asian Investors in Funding Australian Corporates.
In context, it should be acknowledged that despite this growth, Australian corporates have, proportionally, spoken, relied more heavily on bilateral and syndicated loans for core funding than elsewhere in the world. By one account, Ernst and Young estimated that almost 90% of Australian corporate debt in Australia is funded by banks, compared to 54% in Europe and 16% in the United States. While this estimate appears high at least in the Australian corporate institutional segment, bank financings still accounts for an estimated 70-75% of all Australian corporate institutional debt financings, highlighting the significant untapped potential for fixed income growth in the portfolios of Australian institutional funds and retail bond investors. Spurred by strong fixed income investor demand, credit spreads and overall yields have for many years been very low relative to the highs experienced in the midst of the Global Financial Crisis (see Figure 1). Fuelled by low inflation, this combined with low base interest rates resulted in Australian corporates enjoying some of the lowest funding yields on record, a phenomenon also observed in offshore bond markets.

Tenors achievable in the debt capital markets have also extended out much of this benefit has typically not.

Many smaller unrated Australian corporates too have benefitted indirectly from the flow-on effect of lower cost capital being available and while banks remain their primary debt funding source, there have been some embryonic signs of widening institutional risk appetite for such entities (see Section 3). Limited by thin local fixed income markets and the absence of investment grade ratings nevertheless, means that outside traditional bank loans, medium-size businesses continue to be mostly beholden to finding bespoke funding solutions.

Economic and Geopolitical volatility: The multi-year

The multi-year glide path to improved market and pricing outcomes however, has been far from smooth as economic and geopolitical volatility have and continue in 2018 to interrupt market confidence and primary issuance activity. While 2017 was a year unique for the absence of systemic shocks, recurrent shocks before then and into 2018 have had the effect of undermining domestic investor confidence to invest in longer tenors or to limit exposure to lower rated corporate investment grade entities.

With 2018 well-advanced, the topic of market volatility has indeed returned due to a myriad of issues that started with concerns around the impact of rising US treasury rates on global financial markets, and has variously seen the baton passed to compensation for the increased market uncertainty. With global markets being highly interconnected, concerns about global trade wars or the impact of the European Central Bank withdrawing from bond purchases and the associated risk premiums can have highly correlated impacts on local market pricing, even if credit quality remains broadly unaffected (see Figure 4).

Experience continues to show nevertheless that fixed income investors have become more accustomed to dealing with uncertainty. Bouts of volatility, using Brexit in 2016 as but one example have led to brief disruptions in being able to access capital, while others such as the Greek debt crisis in 2015 have led to longer interruptions in

FIGURE 2 LONGER TENORS HAVE BEEN A TREND FOR CORPORATES AND FINANCIAL IN THE AS MARKET

AUD Corporate Credit Spread to Swap (3yr duration)

FIGURE 1 AUSTRALIAN CORPORATE CREDIT SPREADS HAVE BEEN LOW IN RECENT YEARS

AUD Corporate Credit Spread to Swap (3yr duration)
primary debt markets. Australian corporate issuers in turn have become accustomed to being mindful of market conditions and execution risks when they approach capital markets.

While bond investors can be discerning in making their choice of company, sector or tenors, Australian corporates have and continue to have a veritable smorgasbord of debt capital funding opportunities to choose from. It should be acknowledged that despite this, Australian corporate boards, to their credit, have learned from experience and resisted the temptation to sacrifice credit ratings by re-levering balance sheets and increasing leverage back to GFC levels (see Figure 5).

A widening array of bond investors by type and geography, have been critical in expanding their fixed income mandates and being more willing to buy corporate and financial debt across a myriad of structures and tenors. As will be discussed, the stability of the Australian economy and corporate credit quality generally have been attractive to local and global fixed income investors from the Asia-Pacific region and Northern Hemisphere.

Considering Australia’s serially renowned low pension fund allocation to fixed income (10%) versus other OECD countries and the OECD average (40%), this is no mean feat, but in turn highlights the key supporting role of offshore investment in deriving such outcomes. Separate government estimates of Australian superannuation bond holdings suggest that this total is closer to 2% (13% in A$, 8% in international fixed income), but even then at that level, this allocation still remains around half of the OECD average.  

Conversely, Australian superannuation funds have the highest share of assets invested in growth assets amongst developed countries. As such, providing a critical role in funding investment opportunities up and down capital structures, fixed income asset managers have played a critical role in oiling the wheels of commerce with cost effective capital. This in turn has eased pressure off Australian bank balance sheets and ensured financial institutions retain headroom to remain key lenders in the broader economy.

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9. Australian Prudential Regulation Authority: Superannuation quarterly performance data, March 2018
2017 marked not only a record outcome for global primary fixed income volumes but a milestone year for Australian corporates who tapped into this favourable backdrop by issuing bonds across various markets.

The year will best be remembered as delivering some of the most supportive conditions for global bond issuance and secondary performance in over a decade. The stars aligned for fixed income spurred by forces including President Trump’s pro-business/inflation expectations, European Central Bank QE extension, China’s performance stabilisation all of which culminated in significant’s synchronised mix of global growth, positive demand for credit and high grade Australian issuers.

No other year saw the same level of supply. The US$ 3 trillion in new issuance was illustrative of this, by year-end 2017, s-year Australian major bank spreads contracted 2s- 50bp over the year, mirroring a similar compression seen between senior and Tier 2 debt. The Australian Traxx Index also ended -40% lower at year-end compared to the 12 months prior.

In Australia, corporate credit (excluding government/SSAs) broadly returned -5% in 2017 boosting balanced funds returns, while in the US the Bloomberg Barclays US Corporate Bond Index returned -6.47% for the year reflecting the higher weighting of pure BBB corporate holdings.

It is against this positive backdrop, that Australian corporate issuers were also strong beneficiaries of this synchronised mix of global growth, positive demand for credit and high grade Australian issuers.

NAB estimates Australian corporates issued >A$40 billion equivalent of bonds in 2017 across various markets. This marks the strongest year of such issuance since 2013 in a supply rebound from prior years. As an update, at the end of 30 June 2018, aggregate corporate issuance stood at A$43.1 billion suggesting 2018 will see loss issuance overall.

Corporate issuers were attracted by strong investor appetite, competitive pricing, longer tenor interest, heightened execution certainty, and funding diversity opportunities offered by new markets (e.g. US$ Reg Sand Asian local currencies) or product innovation (e.g. green bonds). Buoyed then by the aforementioned factors that drove global issuance, the most notable difference then for 2017 for Australian issuers only (i.e. excluding offshore issuers) is the composition of the issuance split between domestic and offshore.

AS$MTN Market the Standout for 2017

In 2017, the standout market for domestic issuers was the home grown Australian corporate bond market which saw ~A$14.8bn printed (excluding foreign corporate ‘sangrool’ issuance in AS which otherwise added another A$1 bilion of supply).

This came from over so issues, implying the local market accounted for almost one in every two new corporate bond deals by Australian corporates in 2017. A wide array of sectors, tenors and formats were seen in a market where average deal sizes increased.

Global Corporate Bond issuance Record: Good News for Issuers & Investors

At a macro level, Bloomberg estimates that global corporate investment-grade issuance exceeded US$2.2 trillion in 2017 from ~8,300 individual issues. This marked the second consecutive year of rising supply and deal volumes, buoyed by the US which has seen in excess of US$1 trillion in supply each year since 2013.

Bond investors at the same time were beneficiaries of improved issuer diversity, larger deal sizes, anecdotal improvements in secondary liquidity, and performance attributable to spread compression in 2017.

2017’s Supportive Market Backdrop

Positive sentiment visibly evident in global stock indices regularly reached new highs over 2017 also flowed through to credit markets, which in turn converted confidence into new issue activity. Boats of volatility meanwhile that wreaked havoc in H1 2016 were minor in 2017 with the Cboe Volatility Index average (11) the lowest on record.

The combination of significant investible cash, heavy bond redemptions and continued low interest rate settings meant issuers globally were able to reap the benefits of large volume and competitive pricing outcomes. Australian corporate, financial and government issuers were no exception to this rule, with aggregate AS bond issuance volumes hitting a stunning A$151 billion in 2017, up 22% on 2016’s record year.

At the end of the first half of 2018, local markets recorded aggregate AS issuance of only A$69 billion, running marginally behind the prior comparable period. This was largely due to a decline in corporate bond issuance (see Figure 6), noting that ~A$10 billion was printed in offshore markets.

FIGURE 6: H1 2018 CORPORATE ISSUANCE DECLINE REDUCES AS SUPPLY

Global Corporate Bond issuance Record: Good News for Issuers & Investors

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FIGURE 7: WHERE AUSTRALIAN CORPORATES ISSUED BONDS IN 2017

This performance saw AS$MTNs account for 37% of total volume printed. By means of comparison, between 2014 and 2016 Australian corporate MTN issuance accounted for an average of only 22% of total supply which highlights the growing attractiveness of the local market. While there are many reasons the market excelled in 2017, the standout achievement was growth in US$+ demand driven by domestic as well as Asian and Japanese life insurance.

15. Notably, most corporate bonds are typically issued in a senior unsecured and fixed rate format, with the general exception of single asset based entities such as ports, airports and toll roads.
16. NAB’s Global Issuer Database.
Global Public Markets Assert Their Role

2017 also saw a number of larger Australian corporates across the utilities, infrastructure, property and industrial sectors also issue in the 144A/Reg S Sand European bond markets. Most notable was the incidence of strongly received BBB rated issuance in these markets

SECTION 3

Developing Themes for Australian Corporate Debt Issuers

1. Socially Responsible Investment

A key global trend emerging in corporate finance has also been the rise of socially responsible investment (‘SRI’) with the integration of environmental, social and governance (‘ESG’) criteria into investment decisions, and the growth of green and sustainable financing as a means of allowing corporates to demonstrate their commitment to sustainability, doing business responsibly and in a way that contributes to positive environmental and social outcomes. Initially these were demonstrated through green bonds and more recently through loans and other forms of credit facilities.

Green bonds are bonds labelled as ‘green’, with proceeds earmarked to finance projects and related expenditures that deliver positive socio-economic outcomes, and sustainability bonds where proceeds are raised to finance projects and related expenditures that deliver positive environmental outcomes.

Green bonds have been the most developed form of green financing, with US$310 billion in proceeds in 2017, and over $200 billion in 2018. The evolution of sustainable financing has centred on green bond financing, but the market is evolving rapidly with some participants estimating green and sustainability-linked loan growth could exceed green bond issuance.

To date, green bonds have been the most developed form of green financing, noting annual issuance in the global green bond market was worth US$160 billion in 2017, and is anticipated to reach US$200 billion in 2018. The evolution of sustainable financing has centred on green bond financings, but the market is evolving rapidly with some participants estimating green and sustainability-linked loan growth could exceed green bond issuance.

Unquestionably, responsible investment is on the rise and accessing this rising pool of liquidity continues to gain traction across the private and public sectors. Indeed, for Australia’s largest super funds, over 80% have made firm public commitments to manage their funds as responsible investments.

Asset managers in turn are developing funds specifically targeted at SRI. Issuers are taking notice and while activity to date has been more pronounced in the Northern Hemisphere, local entities are tapping into this investor demand and opportunity to create new investment opportunities and sources of funds.

In September 2018, 193 member countries of the United Nations, including Australia, adopted a set of 17 goals known as the United Nations’ Sustainable Development Goals (‘SDGs’) (see Figure 8). These encourage countries and the private sector to focus on 3 dimensions of sustainable development: economic prosperity, social inclusion and environmental sustainability. With growing numbers of issuers using the SDGs as a capital allocation guide, the International Capital Markets Association (‘ICMA’) published guidance in June 2019 aimed at assisting issuers and investors evaluate the contributions of Green/Sustainability/Social Bonds against the SDGs.

In recent years growing numbers of entities have sought to issue green, social and sustainability bonds linked to the SDGs. In 2017, NAB was pleased to assist the Australian Catholic University (ACU) to become the first university in the world to issue a Sustainability Bond which it did via a 10 year A$MTN.

Proceeds from the bond were earmarked to finance best in-class green buildings, along with research and development programs with positive social impact, and contribute towards meeting several of the SDGs.

Other ESG-themed financing examples include bonds that are specifically focused on mitigating climate risk. In late 2016, Monash University also became the first university to issue a Climate Bond Standards-certified green bond raising A$281m equivalent to fund investments which mitigate climate change including green buildings, renewable energy and energy efficiency.

2. Growth in Asian Bond/Debt Investor Participation

One of the most poignant funding developments in recent years has been both the increased participation of Asian investors in A$ bond (and bank) transactions and their even stronger interest in buying Australian corporate bonds in US$ format (principally via the US$ Reg S market).

The rapid development of Asia Pacific’s debt capital markets, as institutions and corporates gear up to serve the region’s growing economies is creating a wealth of opportunities for bond issuers and investors alike. Asian bond markets are expected to continue to flourish as it acts as a channel for the region’s rising prosperity. This reflects Asia’s macroeconomic environment shifting as wealth migrates from the West to the East and middle-class wealth continues to grow.

On the investment side, Asian investors continue to look to show a genuine preference to invest in Australian corporates, not just as an investment opportunity but as a chance to diversify their portfolios. With many corporate issuers now actively targeting Asian investors to bolster their A$ transactions, deals roadshows and execution timing is very much being designed around the Asian time zone. Typically, Asian fixed interest demand accounts for around one third of final order books in an initiative that has been welcomed by Australian corporates for the extra volume, investor diversity and price tension additional demand has brought (Figure 9).

Additionally, from an issuer’s perspective, there continues to be strong issuer interest in the US$ Reg S market as a means to access smaller benchmark volumes of US$300m+ out to tenors of 10 years. From an issuer’s perspective, this represents a more bite-sized issuance amount and has become an attractive proposition for corporates who have typically shied away from larger Northern Hemisphere public markets which require larger minimum primary volumes.
3. Widening Appeal of the Australian Corporate Bond Market

The achievement of the A$ corporate bond market has matured and become a more prevalent funding source for corporates and financials of all sizes, even if it can be fickle at times. In recent years, longer tenors, larger deal sizes and sufficient depth to attract global investors such as Apple, Verizon Communications, The Coca Cola Company and Anheuser Busch InBev highlight this trend. This has seen substantial growth across a variety of tenors, ratings and sectors (see Figure 10).

What is less documented though, is the local market’s progress in connecting a widening array of issuers including higher yield and unrated names through to a broadening suite of high net worth individuals looking for portfolio diversity. For several years now, there have been infrequent but successful financings undertaken by unrated small cap issuers, many of who would have high yield credit worthiness.

The most high profile of these issuers has been Australian data centre operator NEXTDC. NEXTDC has accessed the unrated A$ corporate bond market four times since 2014, including a $300m dual tranche issue in July 2018 bringing its total unrated outstandings to $600m. Most recently B2/B+ rated Virgin Australia issued its first A$ denominated issue, a $100m, 5 year, non-call 3 year bond issue continuing this growing trend, even if off a low base.

Fuelling this trend as well has been the growing breadth of bond investors in search of yield and portfolio diversity. These include a growing pool of local sub institutional investors including boutique private debt asset managers, brokers and Asian private banks, keen on getting access to A$ assets. Some of these retail-linked investors have emerged from the material growth seen in self-managed superannuation and have traditionally focussed on buying corporate and bank subordinated hybrid debt. The aforementioned expanding pool of mid-market investors have undoubtedly contributed to the growth of the A$ high yield and unrated bond space in what remains a bespoke but evolving wedge of the A$ debt markets worthy of further attention.

4. Evolving Engagement of Super Funds & Institutional Term Loans

Australia’s superannuation funds, whose collective funds under management estimated at ~A$2.3 trillion17 and among the largest in the world due to the compulsory superannuation regime, have traditionally been almost invisible in the fixed income landscape.

The role of super funds however has started to slowly evolve with a small but rising number seeking to develop in-house capabilities to manage wide ranging investments and this extends to fixed income and equities. These include some of the larger funds including AustralianSuper, Industry Funds Management and Cbus.

With less pressure to match short term indices and an eye to cost savings, super funds are starting to consider selectively offering Institutional Term Loans to entities with tenors extending in some instances from 7 to 10 years with terms and conditions typically matching those of banks, but with longer tenors. Principally this is a market aimed at unrated issuers, noting at the same time that super funds are expected to remain selective in their assessment of the credit quality of issuers and sectors.

Recent Australian recipients of Institutional Term Loans have been corporates such as industrials such as Brickworks, National Storage and Visy Industries. This follows the A$ term loan B raisings in 2017 for Australian Technology Innovators and an issue by Iron Mountain Australia in 2016, in a modest trend that is symptomatic of increased investor appetite for credit down the capital structure.

The overall development of tapping alternate demand has in itself coincided with a recent high profile ‘Superfunds Roundtable’ in November 2017 co-ordinated by business magnates such as Anthony Pratt, Gina Rinehart, Lindsay Fox and others to see super funds become more active in providing debt funding to Australian businesses17.
CONCLUSION:

Corporate debt markets are expected to continue to be attractive for Australian corporate issuers for risk management purposes and evolving market developments will continue to expand this theme over time as the universe of funding possibilities grows.

Even though it seems the credit cycle is maturing and the cost of term debt likely to rise, the strategic importance of having a well-spread debt maturity profile should prevail.

The depth, diversity and long tenors available in offshore markets will also remain appealing, with the local market playing a key role in being the other bookend of that equation from a tenor perspective. Capital intensive entities with long life capital intensive assets such as in infrastructure, utilities and property, will also retain their traditional bias of matching their asset with long-tail liabilities where it makes sense.

Australian corporates generally are nevertheless expected to maintain their heavy reliance on traditional bank loans given the traditional and important role this market plays in the Australian economy. Credit growth and appropriate asset allocation for Australia’s ageing population aside, domestic market appetite for genuine credit continues to be constrained by the very low investment allocation to fixed income in Australia. Offshore markets will therefore as a result continue to pick up the slack.

As such, the corporate debt capital market space continues to evolve in Australia and solid progress has been made, but much work still remains to bring Australian funding trends in line with international norms.

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NOTE: The views outlined in this paper are those of the author and should not necessarily be construed to represent those of the National Australia Bank.
Introduction

The focus of this paper is on debt finance available to small to medium-sized business customers [SMEs] offered by members of the Australian Finance Industry Association [AFIA]. AFIA SME finance members range from ASX-listed bank and non-bank financiers, OEM-captives, independents through to entities that are SMEs in their own right. Distribution channels include direct or via intermediaries and online access. Products offered are designed to suit SMEs through their life-cycle from start-up, day-to-day consolidation and growth through to major expansion as the business matures.

Key types include: equipment or asset finance and a range of working capital solutions designed to minimise the need for SMEs to spend their personal income or put at risk personal assets including the family-home. Enabling access to affordable capital facilitates innovation and risk-taking with flow-ons to improved capital market efficiency. Diversity in product and providers enables access to SME finance by the financially underserved or disenfranchised segments of the SME population.

Part A: Equipment / Asset Finance

A wide spread of funding options exists. At one end of the spectrum, the SME can assume the asset risk and operating costs associated with the equipment, while at the other the risks and administration can be assumed by the equipment financier. In between, the SME can select the combination of risk, service and ownership structure that suits their particular needs. A full financing solution can provide an SME with installation, maintenance, training and ancillary items included for a single periodic payment over the term of the equipment finance transaction.

There are three main types of equipment or asset finance available in Australia: equipment lease (finance or operating), hire-purchase and chattel mortgage.

EQUIPMENT LEASE

Lease finance in Australia is a mature financial product having been offered as part of a portfolio of financing techniques for over some six decades and generally for periods ranging between two and five years. Providing the commercial use test is met, lessees claim the full amount of the lease rentals as a tax deduction; the lessor, as owner, usually claims the depreciation and usually any investment incentives

Under a finance Lease the lessee (SME) rents the goods; has no ownership entitlement and accepts the residual value risk (ie risk value of asset at end of lease term being less than had been agreed at the outset

Under an Operating Lease the Lessor / financier bears residual value risk as goods are generally returned at end of lease term with no further financial obligation on the lessee.

HIRE PURCHASE

gives the SME the benefit of preserving its working capital as it pays off the purchase of the asset or equipment over time (generally 12-60 months). The SME is the owner for tax and accounting purposes;

In a CHATTEL MORTGAGE the SME holds ownership of the equipment and the financier uses equipment as collateral or security for the loan;

In all of these variants of leasing the implicit interest rate involved in the specified cash flows (or explicit in the case of the chattel mortgage) is typically a fixed rate, and there is flexibility in the pattern of cash flows which may be involved. The introduction of GST in July 2000 saw SMEs move from finance leases initially to hire-purchase (as the transitional GST arrangements did not apply to that product), then from leasing and hire-purchase to chattel mortgage (in large part because of an inequitable GST outcome for cash-based vs accrual-based SME taxpayers, though this has since been addressed). Chattel-mortgage remains the dominant equipment finance product.
The predominant lessor groups are finance companies and banks; lessees include all private and public industry sectors with around 20% of the economy’s capital equipment being leased.

In Australia the main providers of lease finance were traditionally finance companies (including bank-owned lenders, general financiers and captives) and banks. Over the last decade or so nearly all the bank-owned finance companies have been brought into the parent. In recent years, the banks have been the predominant source of lease and other equipment finance, although improved access to funding has seen captives and independents improve their share. More recently with the emergence of the FinTech sector, the online offering of equipment or asset finance has increased.

Lease packagers are involved in structuring some of the more complex transactions. Lease brokers also play a role in promoting the product.


Excluding the fleet leasing sector, 40% was for motor cars and light commercials, 18% for trucks, trailers and buses, 3% for aircraft and other transport equipment, 7% for agricultural machinery, 4% for EDP and office machines, 4% for manufacturing equipment, 1% for mining and construction and 13% for other items.


4. The 2017 Payment Times and Practices Inquiry, conducted by the Australian Small Business and Family Enterprise Ombudsman [ASBFEO], found that in the last financial year one in four businesses experienced an average payment delay of 31 to 60 days past agreed terms.

There are a range of products and providers currently available in the Australian market to offer SME alternates to meet their working capital demands.

DEBTOR / RECEIVABLES FINANCE

Debtors or receivables finance is a form of financing in which a SME on a continuing basis assigns its receivables (effectively as security) to a Debtor Finance Provider which in turn provides a cash advance to the SME (which may be up to 70-80% of the value of invoices outstanding at that time). This helps bridge the cash flow gap between:

- Incurring expenses in providing goods or services to its customers; and
- Receiving payment (from its customers) of invoices for those goods or services.

The remainder is advanced to the SME on collection by the Debtor Finance provider. A fee is charged for both providing the finance and collections management. Any
accounts not collected would also be taken into account from the final amount returned to the SME. Some Debtor Finance Providers may offer the product for a specific, sizeable invoice with a longer term to settle.

Debtor or receivables finance is generally categorised by two types:

- Invoice Discounting is typically not disclosed to the debtor (i.e. the customer who is obliged to pay the invoice to the SME). As the SME generally continues to manage collection, it may be seen as a riskier product and priced accordingly; and
- Factoring is typically disclosed to the debtor so that they are aware the Debtor Finance Provider has been assigned the receivable and there is a higher degree of contact between the Debtor Finance Provider and the SME’s debtors.

Factoring and Discounting products are inextricably linked with current sales and provide a finance solution which does not only accommodate but fosters strong growth performance.

Potential benefits include:

- Pools of cash within 48 hours, usually varying between 75 per cent – 90 per cent, of the value of the invoice as soon as it is issued;
- The ability to utilise the cash flow to obtain early settlement discounts from suppliers/creditors;
- The reduction of management time spent on chasing slow payers;
- The availability of bad debt insurance (known as non-recourse factoring).

DEBTOR / RECEIVABLES FINANCE PROVIDERS:

Debtor Finance Providers include both bank and non-bank entities with (online provision emerging).

MARKET OUTLOOK - AUSTRALIA

The Debtor Finance market in Australia has grown significantly over the last two decades with Industry Turnover increasing from $3.98 billion in 1996 to in excess of $62.5 billion in 2016. For growth SMEs using alternative lending options, based on published data, we understand that debtor finance is by far the most popular working capital financing. The alternative working capital options used by SME respondents in 2017 were: debtor finance (used by 77%), merchant cash advances (23%), P2P lending (10%), crowd funding (9%) and online lending (5%).

Given the prolific media profiling of the growing fintech market, these results may seem surprising.

However, the Index polls SMEs with a turnover ranging from $1 million to $20 million and it is likely that most of the current fintech take-up is from start-ups and small businesses coming in under the $1 million revenue mark.

ONLINE SMALL BUSINESS LOANS

Online SME Loan Providers consist of a mixture of online balance sheet members and market place or peer-to-peer lenders. A key differentiator relates to where funding is sourced and consequently who is the entity that bears the risk; on-balance sheet lenders the risk lies with their business.

The key business model for providers in this market segment is the use of technology as a focal point of their business model to specifically address the financing needs of SMEs and established, multi-channel distribution networks (with a focus on direct marketing and relationships with partners including small business accounting software providers, finance brokers and other POS intermediaries).

MARCH QUARTER 2017 - PERCENTAGE OF FACTORING TURNOVER

However, the Index polls SMEs with a turnover ranging from $1 million to $20 million and it is likely that most of the current fintech take-up is from start-ups and small businesses coming in under the $1 million revenue mark.

MARKET OUTLOOK - AUSTRALIA

There appears to be no current authoritative published source on the size of the online SME lending market size in Australia.

AFIA estimates suggest both consumer and business lending growing by 53% in the 12 months to 31 December 2016 to $819 million. One example of a participant in this sector is Prospa which has served over 12,000 unique clients since its establishment in 2012. Online SME Loan Providers have a diverse distribution of customers across industry, geography, time in trading and size. Most will generally require the SME to have been in business for at least 12 months.

AFIA’s Online SME Lenders Group has also produced a Lending Code of Practice with a focus on greater transparency (including for pricing) and accountability.

INSURANCE PREMIUM FUNDING

Insurance premium funding enables businesses to pay their commercial insurance premiums (including Workers Compensation; Professional Indemnity) in easy to manage monthly installments rather than an upfront lump sum freeing up business cash flow for use elsewhere.

Insurance Premium Finance Providers are a mixture of bank and non-bank financiers.

Products are generally distributed via insurance brokers or online applications.
MARKET OUTLOOK – AUSTRALIA

Based on market provided by AFIA members and reflected in our Insurance Premium Funding Report, relevant market data for commercial products is summarized below:

INSURANCE PREMIUM FUNDING DETAILS

$2.872 Billion

35.5%
6-Monthly Change

9.1%
Annual Change

MERCHANT CASH ADVANCE

A merchant cash advance is a product for SMEs that predominately accepts credit or debit card payments and is suited to retailers on a short-term basis. Merchant cash advances appear similar to unsecured business loans however; they are the process by which a lender technically purchases future card transactions and advances the SME a percentage of their sales. As future sales support repayment the SME owner’s credit history may often not be a critical factor for approval. Evidence of a regular and predictable flow of credit or debit card transactions will help the SME find the funds they need to repay.

The Merchant Cash Advance when traditional small business financing is unavailable. The product can be more expensive than a traditional business term loan but are less expensive than other short-term financing options and may assist a SME take advantage of an unusual business opportunity or a short-term spike in trading.

Merchant Cash Advance payments have no fixed term, SME owners can then repay the advances as they collect cash from customer accounts or make additional sales. One alternate payment mechanism is to have repayment based on an agreed % of future EFTPOS sales. The advance is offered on an unsecured basis and priced based around a ‘factor fee’ which is agreed upon at approval. Application and credit decisions can be completed efficiently and with SMEs advised within 24-48 hours of the outcome. Once approved, funds are deposited into the SME account. SMEs may find the quick access to funds outweighed by convenience.

MERCHANT CASH ADVANCE PROVIDERS

The dominant participants offering the merchant capital product are non-bank financiers that operate in a largely online environment.

CORPORATE CREDIT CARDS + REVOLVING CREDIT

Corporate credit cards provide a means for SME to benefit from being able to acquire assets or services to grow their business providing a term (up to 51 days) before payment is required assisting with cash flow management. By making the SME supplier payments line up with their preferred statement cycle, the SME could have business receivables coming in before business expenses are going out.

MAJOR REGULATORY ISSUES + HOW IS TECHNOLOGY CHANGING THE NATURE OF BUSINESS FINANCE?

Recent years has seen increasing re-regulation of the financial services industry. This regulatory upswing has been driven by public perceptions of poor conduct by industry.

1. ROYAL COMMISSION DIRECTION

As noted earlier, the standard by which SME providers are to be judged going forwards is whether they have behaved in a manner that meets the standard of community expectations which encompasses more than strict legal compliance. Public hearings focusing on small business lending were held 21 May-1 June. The key issues focused on in case studies included credit assessments processes (badged responsible lending) and the taking of guarantees. Self-regulation (via Banking Code of Practice) including how small business is defined was also area of focus. The key issues emerging which will no doubt be addressed in the Commission’s final report include: responsible lending obligations; third party guarantees; and conflicted remuneration.

2. EXPANSION OF ‘CONSUMER’ CONCESSIONS TO SMEs

Expansion of concessions which treat small business like individual consumers have also been a topic of interest. These have included statutory amendments to move to a single external dispute resolution scheme (the Australian Financial Complaints Authority (AFCA)) and increased jurisdiction to consider complaints relating to a business employing up to 100 people and a credit facility up to $5M. Further, November 2016 saw the unfair contract terms protections (UCT) originally implemented for consumers expanded to capture standard form small business contracts.

3. OPEN BANKING & MANDATORY CCR

Government policies around open banking and mandating comprehensive credit reporting are seen to provide the environment for greater access to more data to facilitate better credit decisioning and enhance innovation. However, with mandatory CCR, statutory limitations with access to a key predictive data element, namely, repayment history information, being tied to the holding of an Australian Credit License, means its potential is devalued with SME financiers unable, at this time, to access that dataset.

There is potential for open banking through improved data access to lead to new products and services that transform SME experience in financial services. Increased data access should also assist SME providers to reduce their regulatory compliance costs.

4. PERSONAL PROPERTY SECURITY REFORM

The Personal Property Security laws (PPSA) assist SME financiers involved in equipment, motor or debt/receivables finance to manage risk and price their products accordingly.

While the PPSA offers benefits to secured financiers, it also presents significant risks which can sometimes result in diminished or lost security rights. In some instances, these risks cannot be effectively managed by a secured party, due to circumstances beyond its control, even if it has correctly registered its security interest in a timely fashion. These risks arise particularly in relation to equipment sub-leasing and inter-corporate group equipment hiring arrangements.

There are a number of proposed/ supported changes arising from the Whittaker Review recommendations which will provide greater clarity and ease of understanding and operation of the PPSA and the PPSR.

5. FINANCIAL LITERACY

A key limitation in utilisation of non-traditional bank finance by SMEs to support and grow their businesses is a lack of awareness or understanding by SMEs and their trusted-advisers of the diversity and depth of alternative options for SME financiers.

Further, November 2016 saw the final implementation of the Whittaker Review recommendations which will provide greater clarity and ease of understanding and operation of the PPSA and the PPSR.

Please refer to details in the footnotes that accompany this paper.

REFERENCES

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