FinTech Australia

Australian Government

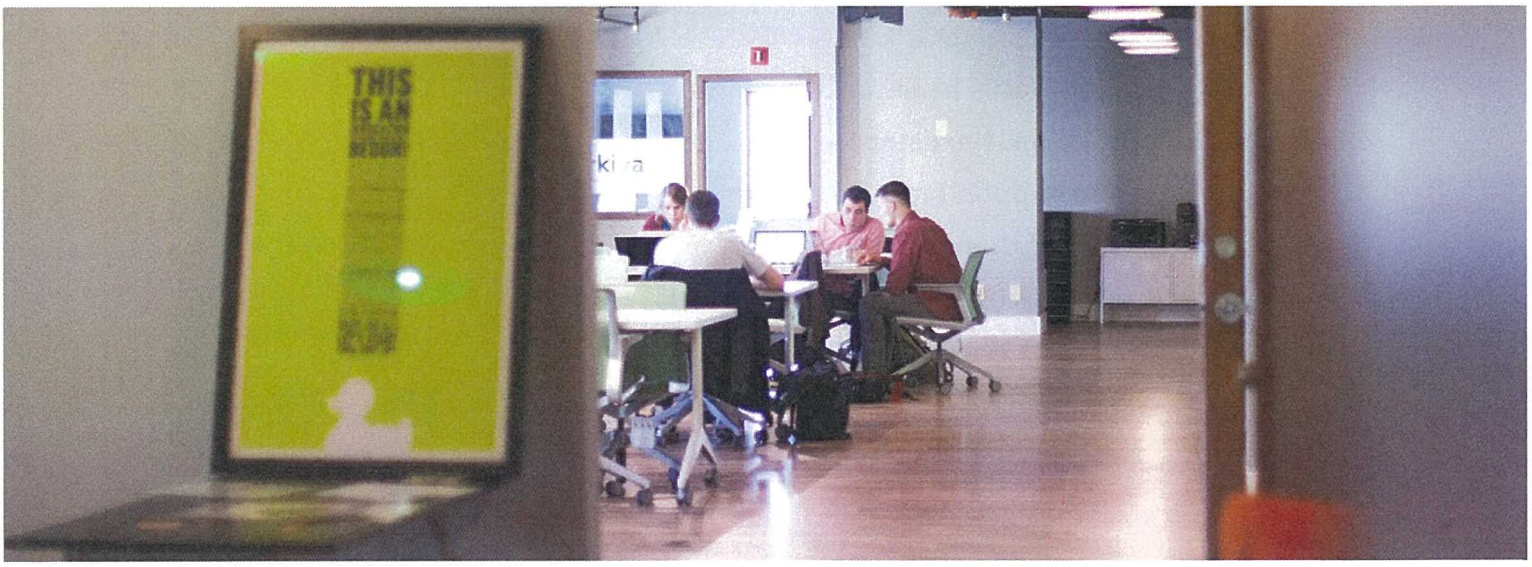
Australian Small Business and Family Enterprise Ombudsman

the BankDoctor

Fintech lending to small and medium-sized enterprises

Improving transparency and disclosure

February 2018



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Foreword

From the Australian Small Business and Family Enterprise Ombudsman

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) is a statutory office which acts as an independent advocate for small business, ensuring that legislation, regulation and business practices enable this vital sector to innovate, create jobs and grow.

Australian small businesses make up more than 99% of all Australian businesses, contribute $380 billion to the economy and employ more than 5.5 million people. Access to debt and equity finance is critical to their success and the Australian economy.

I commend the fintech industry for its leadership in the financial services industry in addressing the needs of small business borrowers. Australia presents a huge opportunity for the fintech industry. It presents a genuine alternative finance solution for small businesses where traditional banks are limited in their capacity to serve the sector.

This report will inform both the fintech industry and small business borrowers of the steps being implemented to increase transparency and disclosure, allow comparison of products and ensure loan agreement contracts comply with the unfair contract terms legislation. These steps capture learnings from my Small Business Loans Inquiry, the Ramsay Review of financial services external dispute resolution, the Khoury Review of the Australian Bankers' Association (ABA) Code of Banking Practice and Ian McPhee's review of the ABA's Better Banking six point plan.

Our particular focus through the process was improved transparency and disclosure. It is accepted that borrowing costs of fintechs will be higher than banks, as loans are secured against business activities and not bricks and mortar, but the total of these costs – the effective interest rate – is not always clear.

This lack of transparency has made it difficult for a small business to compare products offered by different fintechs, or products offered by fintechs and banks. To make informed decisions on the best product to meet their needs, small business borrowers must be able to compare total costs, understand the obligations to exit early and the penalties if payments are missed, and trust that disputes will be dealt with quickly and fairly, avoiding costly legal processes. Finally, it will also be important to make small business borrowers aware of fintechs as a trusted alternative source of finance.

I would like to thank the valuable contribution and expertise of Fintech Australia and theBankDoctor.org, who were partners in this collaboration. I would also like to congratulate the fintech businesses who participated and applaud the efforts to move to industry-led self-regulation. I will keenly monitor progress against the resolutions in this report.

Kate Carnell AO
Australian Small Business and Family Enterprise Ombudsman

From FinTech Australia

Fintech business lenders are making a real difference, and are delivering a genuine alternative to the banks when it comes to helping Australian small to medium businesses access the funds they need to grow.

Through the use of technology platforms to provide easy-to-use and fast application and decision-making processes, and the ever-increasing access to rich, real-time business financial data, fintech business lenders are able to offer cost-effective loan products and service smaller, short-term loan requests, which cannot be easily offered by the banks.

However, like many financial services products, lending contracts are complex, and have the potential to be complicated and confusing. It's for this reason our lenders have decided to work together – in a historic move for Australia's fintech industry – to help define best-practice transparency and disclosure.

This report represents an important step in this initiative, exploring the different approaches to disclosure across the industry and suggesting a way forward to drive results which are in the best interests of the customer.

It also publishes an analysis of various regulations affecting the industry, and for the first time, the Glossary of Common Lending Terms. The use of consistent definitions, where possible, should help make contracts easier to understand across lenders.

The report is a strong platform to build transparency and disclosure when it comes to fintech business lending, and to help this industry continue its good work into the future.

I thank FinTech Australia's business lending working group, who have worked tirelessly through many meetings and calls to reach consensus, along with the Australian Small Business and Family Enterprise Ombudsman, her team, and theBankDoctor.org, for their dedicated work with us to make this report a reality.

Danielle Szetho
Chief Executive Officer
FinTech Australia

Acknowledgements

We would like to thank the fintech business lenders for their contribution toward this report and research project. These included:

banjo

www.banjoloans.com

BIGSTONE

www.bigstone.com.au

beyond merchant capital

www.beyondmerchantcapital.com.au

GETCAPITAL

www.getcapital.com.au

tim. THE INVOICE MARKET

www.theinvoicemarket.com.au

MOULA

www.moula.com.au

ondeck

www.ondeck.com.au

prospa

www.prospa.com

Rate%Setter™

www.ratesetter.com.au/

www.sail.com.au

Skippr

www.skippr.com.au

Spotcap

www.spotcap.com.au

TruePillars

www.truepillars.com

From theBankDoctor.org

With twenty-five years' experience in a big four bank and the last five years as an independent not-for-profit advocate for small business, I know how difficult it has become for SMEs to raise funds. This is especially true for businesses that want to borrow less than $250,000 and have no property to offer as security.

Fortunately, fintech lenders have emerged as an option for those who cannot or do not want to borrow from a bank. But in order to safely achieve its undoubted potential, greater awareness and understanding about borrowing from fintech lenders is required. Currently, a lack of transparency and consistency, especially in relation to the total cost of borrowing, makes it challenging for time poor and often financially unsophisticated small business owners to make fully informed decisions.

We need a level playing field for both borrowers and lenders so business owners are able to make fully informed decisions and lenders can compete on an equal footing. Put simply, borrowers should be able to answer three simple questions:

1. Is this the right product for my needs?
2. Do I know exactly what it is going to cost?
3. Do I know that I can't get a better deal elsewhere?

This project has brought together a group of fintech lenders that want to self-regulate with the Australian Small Business & Family Enterprise Ombudsman. The report highlights where and how fintech lenders can implement consistent transparency practices that will create better outcomes for SMEs and help build further credibility and trust in the fintech lending sector.

FinTech Australia, and the survey respondents who are mostly SMEs themselves, have embraced this opportunity to self-regulate and in so doing are setting standards for other non-bank lenders to follow. The publication in this report of a Glossary of Common Lending Terms is an important step forward.

Industry self-regulation can be difficult to achieve without guidance from regulators and other public officials. Kate Carnell and her team have been constructive and collaborative in helping fintech lenders reach agreement on areas in which more can be done to improve SME understanding of and access to this alternative form of debt finance.

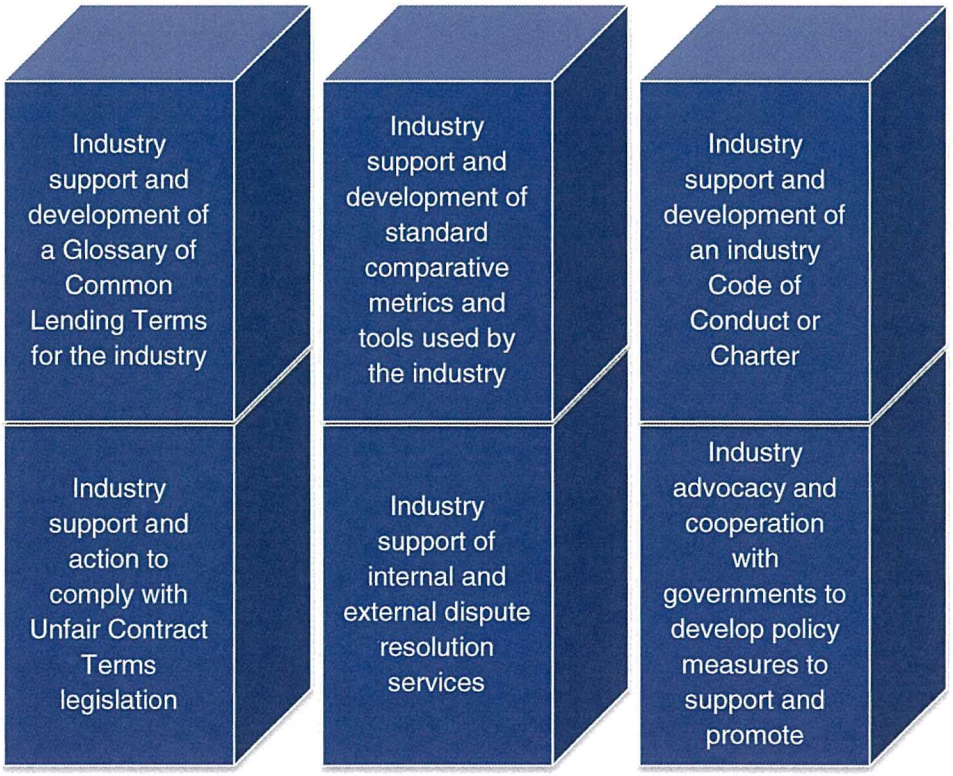
The role of theBankDoctor.org has been to bring the various parties together while representing the interests of small business owners. As a not-for-profit small business advocate, we exist to help SMEs with the challenges of funding their business. We look forward to continuing to work with fintech lenders and regulators to achieve this goal.

Neil Slonim
theBankDoctor.org

Executive Summary

Fintech-enabled non-bank SME lenders[1] ('fintech business lenders' for the purpose of this report) are an emerging alternative to banks for small- and medium-sized enterprise (SME)[2] borrowers, often through seamless and highly automated online application, assessment and decision processes. But with rapid growth in the number of lenders and the variation of fintech products, it becomes more difficult for SMEs to make informed decisions about which products and lenders best suit their circumstances. This research highlights areas where the implementation of consistent practices for transparency and disclosure in relation to fintech loans can create better outcomes for SMEs and help build further credibility and trust for the fintech sector in the long-term.

Fintech business lenders are being proactive to ensure best practice and transparency within their sector. While the discussion about 'next steps' for improving lending practices focuses specifically on this sector, some of the recommendations are equally relevant to all providers of SME lending. Fintech business lenders have an opportunity to take a lead on improving lending practices and establish broader good lending practices. The industry identified **six key pillars for focusing industry self-regulation and action**:



[1] The report discusses "fintech lending to SMEs". By this we mean "fintech-enabled alternative finance (i.e. non-bank) SME lending".
[2] For the purposes of this research, SMEs are defined as businesses with 0 to 199 employees.

This report forms the first part of a collaborative research project by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) with the not-for-profit industry association FinTech Australia and independent SME finance expert Neil Slonim from theBankDoctor.org to focus actions. The second part will be advice and tools for SMEs wanting to borrow from a fintech business lender.

Following the industry roundtable meeting held on 13 December 2017, the roundtable participants resolved that:

- FinTech Australia would finalise a glossary of terms to distribute with this report (covering unsecured small business loans, and potentially split for balance sheet versus peer-to-peer lending)
- an industry working group would be formed, which will consult with stakeholders to develop a Code of Conduct by June 2018 to cover fintech balance sheet lending, for unsecured business loans that:
    - outlines best practice principles
    - is customer-centric and outlines what a customer can expect
    - prescribe the comparative measures such as APRs and total cost to be provided to potential borrowers
    - would be expanded upon in future to cover other loan products, on a product by product basis
- fintech business lenders would work with the ASBFEO to ensure they comply with the Unfair Contract Terms legislation
- ASBFEO would facilitate a discussion between fintechs and the Australian Financial Complaints Authority to explore alternative external dispute resolution services in early 2018
- by June 2018 the industry working group would agree on a common set of plain English key terms and conditions to be highlighted in a summary page in all loan agreements
- ASBFEO and theBankDoctor.org would write an education piece for SMEs, in consultation with industry, that will coincide with the outcomes from the actions above.

1. Introduction to fintech business lending

Fintech in Australia

The word 'fintech' is a term used to collectively refer to both startups and more mature businesses that are harnessing advancements in technology to improve delivery and/or reduce the cost of financial services and products. It is an area that has seen a remarkable rise in investment and growth worldwide and increasing traction with consumers who value the efficiency of service and reduced cost, with Australia proving to be no exception.

The focus of this report will be on tech-enabled alternative finance that is available to small and medium-sized enterprises (SMEs). This should be considered in the context of the wider fintech sector which includes activities such as payments, fund management and lending to consumers and businesses.

The number of fintech startups in Australia has increased from less than 100 in 2014 to 579 companies today. More than 10,000 people are employed in the sector. An increasing amount of money continues to be invested in Australian fintech from domestic and international funds. In 2016, $656 million was invested in Australian fintech companies across 25 deals, bucking the global trend that saw an overall dip[3].

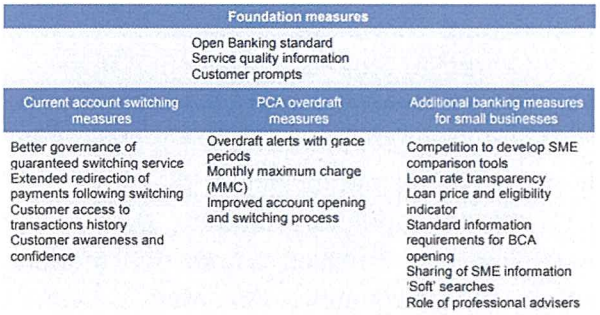
The development of the Australian fintech sector has attracted broad-based support from both sides of government, particularly in recognition of its potential to improve consumer outcomes and increase competition. The recent Federal Budget announcement in May 2017 saw the announcement of several fintech-friendly policy commitments, including a move towards an Open Banking regime in 2018, and an expanded regulatory sandbox. Both measures were aimed to facilitate the growth of new, viable alternatives to traditional models by making it easier for fintech companies to establish, and for consumers to switch to them.

A series of high-profile scandals has also meant consumer trust in Australia's big banks has declined; the recent *EY Fintech Adoption Index* report found that 37% of Australia's digitally active population are now fintech users, and the number of Australians who said they would prefer to use a traditional financial services provider has dropped to 10%[4].

The international regulatory environment

Transparency, disclosure and responsible lending are also being tackled internationally by governments and industry organisations. The table below provides examples from the United Kingdom and the United States.

[3] Scaling the Fintech Opportunity for Sydney and Australia, Issues Paper 17, KPMG for The Committee for Sydney, July 2017
[4] EY FinTech Adoption Index Report 2017, EY, August 2017

United Kingdom	United States
The UK Government has established a number of initiatives and policies to promote innovation and facilitate growth of the fintech industry (e.g. regulatory sandbox). There are some transparency and disclosure rules built into these initiatives and policies but the industry has taken it further by self-regulating transparency, disclosure and standards. UK's Peer-to-Peer Finance Association (P2PFA) has a membership that includes consumer lending, business lending and invoice finance funding for small businesses. P2PFA requires members to operate "by a strict set of principles and rules in order to promote high standards of conduct and consumer protection". They do this by requiring members demonstrate their compliance against a set of principles and rules (e.g. requiring members to demonstrate they have published standardised information on publicly available pages on their website). There are provisions for the association to conduct inquiries in the case of breaches and require members to change behaviour or be expelled from the association.  The UK Competition and Markets Authority (the UK competition regulator) has required from 2 August 2017 new pricing rules on business loans. Alternative finance lenders specialising in unsecured loans and overdrafts of up to £25k to SMEs are to publish and clearly display annual percentage rates. While P2P lenders were excluded from this requirement, it is expected that market pressure will result in P2P lenders also displaying Annual Percentage Rates (APRs)*.	The fintech sector is largely regulated by the states in the United States. However, the US Office of the Comptroller of the Currency are in the process of passing federal fintech legislation. US Federal Government agencies also enforce compliance with particular consumer protection laws. Similarly to the mature UK market**, the fintech industry in the US has taken steps to self-regulate transparency, disclosure and standards. Marketplace Lending Association and the Small Business Borrowers' Bill of Rights are examples of two industry associations that require members to adhere to high standards of transparency, fairness and consumer protection. The industry-led SMART Box[5] initiative has also been established to provide a standardised comparison tool to improve transparency and disclosure around their products to SMEs. A variant of SMART Box is also being considered for adoption by the sector in Canada, where regulatory bodies are also demanding increasingly detailed reporting and greater levels of transparency.

* It should be noted that in contrast to the UK, the Australian SME fintech market has a much larger proportion of balance sheet fintechs.** The US market is seen as the most mature of the fintech business lending markets worldwide. In 2017 the US SME lending market volume was US$7.2 billion[6] compared with Australia's SME lending market volume of US$354 million[7].

[5] SMART Box ("Straightforward Metrics Around Rate and Total cost") is a voluntary tool that requires signatories to disclose and use common pricing metrics, calculations and language.
[6] The 2017 Americas Alternative Finance Industry Report; T. Ziegler, E.J. Reidy et al.
[7] The 2nd Asia Pacific Alternative Finance Benchmarking report; K. Garvey, B. Zhang et al.

The current regulatory environment in Australia

Depending on their business model, fintech business lenders are subject to various degrees of regulation in Australia. They are subject to oversight by a variety of government and industry organisations, including ASIC, APRA, AUSTRAC (know-your-customer and anti-money laundering checks), the OAIC (Privacy law) and the ACCC. Fintech business lenders are also required to comply with Australian Consumer Law.

Australian Securities and Investments Commission (ASIC)

ASIC is Australia's corporate, markets and financial services regulator, responsible for licensing and monitoring financial services businesses to ensure they operate efficiently, honestly and fairly. SME business lending does not need authorisation by ASIC but certain prohibitions may apply under the ASIC Act, including more recently the unfair contract terms provisions. Among other relevant responsibilities, ASIC oversees lending conduct and advertising, and licensing of fintech lenders engaged in certain regulated financial services activities, including P2P lending for consumers.

Fintechs who lend to consumers are required by ASIC to have a credit licence and to hold membership with an External Dispute Resolution (EDR) service such as the Financial Ombudsman Service (FOS) or the Australian Financial Complaints Authority (AFCA) in respect of their consumer lending activities. Small business customers can access these EDR services due to the fintech lender's membership status, if they fit the definition of small business and are within loan and compensation limits[8]. However, fintechs who lend only to business are not required to hold a credit licence.

ASIC productively engages with Australia's fintech sector. Greg Medcraft, former Chairman of ASIC, has said "Fintech also has potentially enormous macroeconomic benefits through enhancing financial inclusion and bridging the financing gap—particularly in emerging markets"[9]. Recognising the potential benefits of the fintech industry, ASIC has signed agreements and collaborates with other jurisdictions to allow Australia's fintech sector to expand.

Recommendations from David Murray's Financial System Inquiry highlighted the benefits of innovation and technology for ensuring a dynamic and competitive financial system. ASIC identifies emerging fintech-related business models as part of its monitoring of domestic and international markets. Recognising the potential opportunities, ASIC has created an Innovation Hub to assist with licensing enquiries, and a fintech "regulatory sandbox" designed to reduce barriers to entry for new innovative fintech businesses.

While fintech lenders are not an eligible sandbox category, the sandbox allows fledgling fintech companies to conduct limited, controlled pilots of particular categories of financial

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[8] https://www.fos.org.au/small-business/our-small-business-jurisdiction.jsp. FOS considers disputes from business that have less than 20 employees, or where the business is or includes the manufacture of goods, has less than 100 employees. The maximum of any individual claim may not exceed $500,000, however a single dispute can also contain more than one claim.

[9] Speech by Greg Medcraft, Chairman of ASIC, at the British Australian FinTech Forum, April 2017

products and services without an Australian financial services licence at launch. All companies using the scheme need to meet ASIC's conduct and disclosure rules, have membership to an external dispute resolution service, and are required to gain an Australian financial services licence within one year if they wish to continue to provide regulated products and services.

Australian Prudential Regulation Authority (APRA)

APRA is the prudential regulator of the Australian financial services industry, largely funded by the industries it supervises. It oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, private health insurance, friendly societies, and most of the superannuation industry.

Australia's banking sector is highly concentrated – the four major banks hold approximately 80% of retail deposits, and supply over 80% of all mortgage and business loans[10]. In a recent submission to the Productivity Commission's Inquiry into Competition in the Australian Financial System, APRA acknowledged that "there is likely to be less competition occurring in lending to small- and medium-sized businesses", and that "provision of finance to small- and medium-sized enterprises is an important area of the economy which may benefit from the increase in the number of innovative financiers such as peer-to-peer or marketplace lenders"[11].

APRA has become increasingly active in its regulation of the financial sector, particularly through the introduction of lending caps and regulatory guides for Authorised Deposit-taking Institutions (ADIs) in an effort to curb excessive growth in the residential mortgage sector[12]. A draft bill was recently released for consultation seeking to give macroprudential regulator APRA even further oversight over non-ADI lenders amid concerns about the over-heated mortgage market, including a new proposed requirement for non-ADI lenders of a certain size to report regularly to APRA[13].

Recent regulatory changes affecting fintech business lenders

The broader Australian regulatory landscape in relation to financial services is currently undergoing tremendous change. Among other recent changes:

- In 2016, section 23 of the Australian Consumer Law was extended to protect small businesses[14] from unfair terms in standard form contracts.[15] This change was also reflected in the equivalent section 12BF of the Australian Securities and Investments Commission Act. The revision required fintech business lenders to review their standard form contracts, and to ensure compliance by 12 November 2016. At the

[10] Based on analysis of APRA Banking statistics, April 2017
[11] APRA Submission to the Productivity Commission Inquiry into Competition in the Australian Financial System, September 2017.
[12] APRA Media Release, *APRA updates guidance on residential mortgage lending*, February 2017.
[13] Australian Government – The Treasury, *New APRA powers to address financial stability risks – Non-ADI lender rules*, August 2017
[14] defined as businesses with fewer than 20 employees where the upfront price payable under the contract is no more than $300,000 or $1 million if the contract is for more than 12 months.
[15] ASIC Information Sheet 211 (INFO 211), *Unfair Contract Terms for Small Businesses*, February 2016

direction of ASIC and ASBFEO, the four major banks have recently revised their standard form small business lending contracts to remove certain provisions that ASIC and ASBFEO had deemed non-compliant with the Act[16].

- On 14 February 2018, Federal Parliament passed a bill to establish the Australian Financial Complaints Authority (AFCA). AFCA is the new one-stop-shop dispute resolution scheme for financial services complaints from small businesses and consumers. AFCA will replace both existing external dispute resolution schemes (FOS and the CIO), as well as the Superannuation Complaints Tribunal (SCT)[17].

- In February 2018, Federal Parliament passed a further bill to enhance APRA's crisis management powers[18]. This included an expanded remit to set requirements for resolution planning and ensure banks and insurers were well prepared for a crisis, and an expanded set of crisis resolution powers so APRA could act decisively to resolve a distressed bank or insurer. Of particular note to fintech business lenders, the bill expands APRA reporting requirements to non-bank lenders with loan books over $50 million.

- In February 2018, Federal Treasury released the report of the Open Banking Review chaired by Scott Farrell, containing 50 recommendations on the "regulatory framework, the type of banking data in scope, privacy and security safeguards for banking customers, the data transfer mechanism and implementation issues" for an Open Banking regime in Australia[19]. The report recommends that all authorised deposit-taking institutions (ADIs) and Open Banking regime participants, starting with the major banks[20], should implement Application Programming Interfaces (APIs) to allow their Consumer and Small Business customers to share their transaction data with accredited third parties of their choice. The Open Banking regime's design is specifically intended to enable greater choice and competition in financial services, including greater access to relevant small business financial transaction data for fintech business lenders. Consultation on the recommendations will conclude in late March 2018.

- In November 2017, Federal Treasury also announced it would legislate for a mandatory Comprehensive Credit Reporting regime, requiring the four major banks to provide comprehensive credit information to their contracted credit reporting bodies by 1 July 2018[21]. This initiative will result in much richer data about borrowers being available to both bank and non-bank lenders if they also supply comprehensive credit information. The intent is to enable lenders to more effectively assess risk and

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[16] Australian Small Business and Family Enterprise Ombudsman Media Release, *Big four banks change loan contracts to eliminate unfair terms from small business contracts* , August 2017.
[17] Kelly O'Dwyer, *Putting Consumers first – improving dispute resolution*, September 2017
[18] The 2nd Asia Pacific Alternative Finance Benchmarking report; K. Garvey, B. Zhang et al
[19] *Review into Open Banking in Australia*, Australian Federal Treasury, February 2018.
[20] The report recommended that foreign bank branches be excluded, and that a phased approach be undertaken beginning with the four major banks, who would be required to comply within 12 months of the Government's final decision on Open Banking. Other ADIs would be required to comply from 12 months after the major banks.
[21] *Mandatory Comprehensive Credit Reporting*, Australian Federal Treasury, February 2018.

price loans for customers more accurately. Consultation on the proposed legislation will conclude in late February 2018, with the bill introduced to Parliament shortly thereafter.

Self-regulation of Australia's fintech industry

The financial services sector in Australia, particularly the big four banks, have been hit by negative public confidence and trust in recent years. In contrast, the fintech industry has continued to enjoy high customer satisfaction levels. Awareness and use of fintech financial products is increasing and the sector is growing fast – as such, the increased scrutiny on practices in the wider financial services sector has triggered consideration of the need for fintech industry self-regulation. Any misstep from a fintech lender could potentially damage the broader industry's reputation and inhibit its ability to provide much needed financial support for SMEs.

Prior to the commencement of this research report, a number of fintech business lenders had already shown support for an industry-led charter, developed by fintech broker Valiant Finance. A number of fintech business lenders were also developing a glossary of terms under the auspices of FinTech Australia in an effort to standardise the definitions of common terms, and promote better understanding of these terms to SMEs. The Glossary supported the fintech business lenders survey and has been expanded further following the survey and subsequent roundtable to encompass further terms (Appendix A).

The continued and sustainable growth of this sector necessitates further proactive changes to improve transparency, fairness and accountability, and to prevent any practices which mislead or disadvantage SME borrowers.

Challenges faced by SMEs accessing finance in Australia

Australia's 2.2 million SMEs employ two thirds of Australian workers and create a substantial proportion of new jobs. Ensuring that SMEs have access to capital is critical to enable their businesses to grow and to create jobs in the economy.

SMEs rely on credit for a number of business activities. According to ABS data[22], the key reasons why SMEs seek debt or equity finance are to:

- maintain short-term cash flow
- replace or purchase equipment or machinery
- pursue expansion opportunities, or
- ensure the survival of the business.

[22] ABS, Selected Characteristics of Australian Business, 2014–15, cat. No. 8167.0

The fintech industry has the potential to fill the gap in SME lending

There is no perfect indicator that measures the gap in small and medium-sized business lending.[23] Most information is either anecdotal or only tells part of the story. For instance, ABS data shows that 15% of the 'businesses' surveyed sought debt or equity finance in 2015-16.[24] Of the businesses that sought debt finance, nine in 10 reported success. Of note, only 30% of those that sought finance were small businesses, defined as employing less than 20 people. A report by CPA Australia indicates that less than half of the 508 small businesses they surveyed found it easy or very easy to access external finance in 2016.[25]

The ASBFEO Inquiry into Small Business Loans revealed traditional lenders:

- characterise SMEs as high complexity but low scale, making the sector unattractive to traditional lenders given the high cost to serve each individual client
- view SME lending as high risk as in many cases there is a lack of fixed assets to secure against a loan and SMEs are more sensitive to macro-economic trends
- in addition, traditional lenders have higher regulation and prudential capital requirements for loans to SMEs.

The ABS data also shows the proportion of businesses seeking finance rises as the business size increases. CPA Australia states that growing businesses are significantly more likely to seek external finance.[26] The most common type of finance sought by SMEs is debt finance[27] (over nine in 10 businesses seek debt finance compared to around 2–3 in 10 businesses seeking equity finance).

Total bank lending to businesses was almost $346 billion in 2016–17, yet only around one in 25 bank lending commitments to businesses were for less than $100,000[28]. In contrast, more than half the surveyed fintechs determined their 'sweet spot' (a term generally used to suggest what $ amount was typically sought from a lender by small business owners) was for less than $100,000.[29] This is consistent with a Harvard Business School Working Paper finding that a gap existed in the United States in small business access to credit and was "particularly persistent in small dollar loans"—those defined as under $250,000[30].

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[23] The statistical evidence from surveys is poor globally. But the growth in fintech in the United States and the United Kingdom alone where SME finance of all types is more developed provides strong evidence that Basel III regulations strongly disincentivises banks from SME lending.

[24] ABS, Selected Characteristics of Australian Business, 2015–16, cat. No. 8167.0. The ABS survey included large business (200 or more persons).

[25] Based on businesses with less than 20 employees. CPA Australia, The CPA Australia Asia-Pacific Small Business Survey 2016 – Market Summary: Australia, February 2017

[26] CPA Australia, The CPA Australia Asia-Pacific Small Business Survey 2016 – Market Summary: Australia, February 2017.

[27] Debt finance includes any finance the business must repay. Equity finance includes finance provided in exchange for a share in the ownership of the business.

[28] RBA Statistical Tables, D7.4 Bank Lending to Business – New credit approval by size and by purpose, accessed 6 November 2017 from http://www.rba.gov.au/statistics/tables/

[29] Fintech Lending to SMEs Survey 2017 (n=19).

[30] Mills, K and McCarthy B, The State of Small Business Lending: Innovation and Technology and the Implications for Regulation, Harvard Business School Working Paper 17-042, accessed from http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf

This gap in credit availability is increasingly being filled by fintechs (and other alternative finance) disruptors, who use technology and innovative business models to originate, assess credit risk and fund loans – with easy application processes and quicker turnaround times. This makes fintech products attractive to time-poor SMEs. According to Federal Treasury, innovative fintech solutions can assist small businesses manage their cash flow and working capital, and can efficiently and effectively provide stable funding for small business growth activities.[31]

Fintech business lending in Australia

Australia's fintech SME lending sector is still young but recent growth figures indicate it has the potential to develop into a strong and healthy alternative to traditional bank lending to the SME sector.

The latest *Asia-Pacific Alternative Finance Benchmarking Report* from KPMG et al. reported that Australia's alternative finance sector (which includes crowd-funding and fintech consumer lending) is the second largest in the APAC region by loan value originated, second only to China. The value of lending by fintech business lenders in particular has grown dramatically, from approximately US$10 million in 2013 to over US$354 million in 2016[32]. But this still represents a tiny proportion of total lending to Australian businesses.

The KPMG report also estimated of the total value of finance originated to Australian businesses by alternative finance providers, lending by balance sheet lenders was estimated at US$217 million, invoice traders at US$130 million and P2P business lenders at US$7 million, though this value may understate the total value of lending by P2P lenders to businesses, as several platforms extend loans to both consumers and businesses without distinguishing between the two in information disclosures.

Broadly, a fintech business lender can be characterised as either a balance sheet lender or a P2P (marketplace) lender. Some fintech business lenders have also developed specialisation in invoice and supply chain finance, and can likewise be characterised using the below categories depending on their business model.

Balance sheet lenders originate loans using funds raised as debt and/or equity, typically from institutional or wholesale investors. Loans originated are held on the lender's own balance sheet as assets, and the lender is entitled to the payments of principal and interest from borrowers; separately, investors receive the return they have agreed with the lender. Investors do not directly bear the risk of delinquency for any given loan, however investor returns may be affected if the portfolio of loans originated by the lender do not perform as expected.

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[31] The Treasury, *Backing Australian FinTech, Economic benefits of FinTech*, March 2016

[32] KPMG et al, *Cultivating Growth: The 2nd Asia-Pacific Alternative Finance Benchmarking Report*, September 2017. Figures include Business Balance Sheet Lending, Invoice Trading and P2P Business Lending only.

P2P lenders either establish a direct economic relationship between an investor (typically an individual, a company or a self-managed superannuation trust) and one or more borrowers, or use a trust structure which enables investors to invest in portfolios of loans, which is facilitated via an online marketplace platform. Investors are entitled to payments of principal and interest from the borrowers to whom they have been matched, and the platform typically levies a fee on returns as compensation for operating the marketplace platform. Investors directly bear the risk of delinquency by the borrowers to whom they have been matched.

Invoice and supply chain finance is carried out to meet the short-term cash flow needs of a business that have arisen due to unpaid invoices.

Fintech brokers have also emerged, who provide a free service to SMEs by matching them with a loan option based on their requirements, often from a set of competing fintech business lenders through an online platform. These brokers generate revenue through commissions and fees paid by lenders.

In order for SME borrowers to make informed decisions on fintech business lending products they need to know:

- Is this the most appropriate product for my needs?
- Do I know precisely how much it is going to cost?
- Can I readily be satisfied that I cannot get a better deal elsewhere?

2. Research survey

Overview and methodology

An online survey consisting of 49 questions was authored by representatives from ASBFEO, FinTech Australia member organisations and theBankDoctor.org. The survey was distributed to 25 fintech business lenders (16 of whom are members of FinTech Australia). Nineteen completed survey responses were received, and the report's authors would like to thank these lenders for their time and contribution to this important research.

Thirteen survey participants requested that their individual survey responses remain confidential, predominantly due to concerns that responses may be misrepresented or misinterpreted without supporting context due to the specifics of their business models. It was also important to participants that competitive dynamics of the fledgling fintech business lending market not be affected via promotion of one or several particular lenders over others.

All survey participants agreed that aggregated survey responses may be subsequently reported and analysed. Underlying data from the report remains the property of the ASBFEO and may not be analysed or reproduced without express permission.

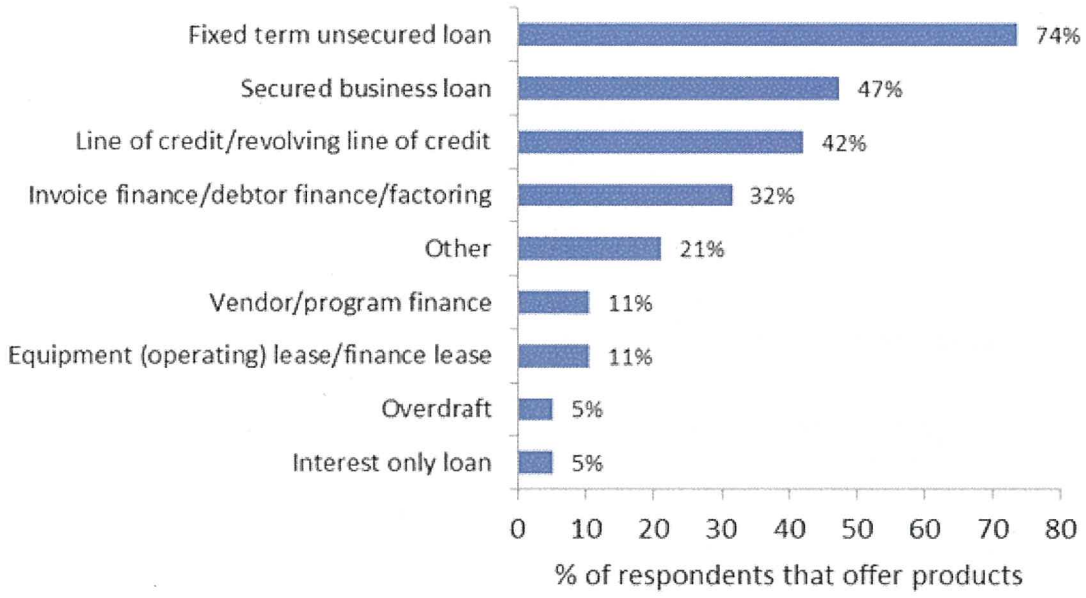
3. Key findings

Market overview

In keeping with the needs of SMEs who often do not have fixed assets against which to secure a loan, 74% of participants offer a fixed term unsecured loan. Invoice finance is offered by 32% of participants and only 5% of participants offer interest only loans or overdraft facilities.

The most common type of product offered by surveyed invoice finance fintechs was invoice finance/debtor finance/factoring, followed by line of credit/revolving line of credit. The most common type of product offered by surveyed P2P lenders was secured business loans, followed by fixed term unsecured loans. The most common type of product offered by surveyed balance sheet lenders was fixed term unsecured loans, followed by line of credit/revolving line of credit.

Figure 1: Types of loan products offered by fintechs lending to SMEs



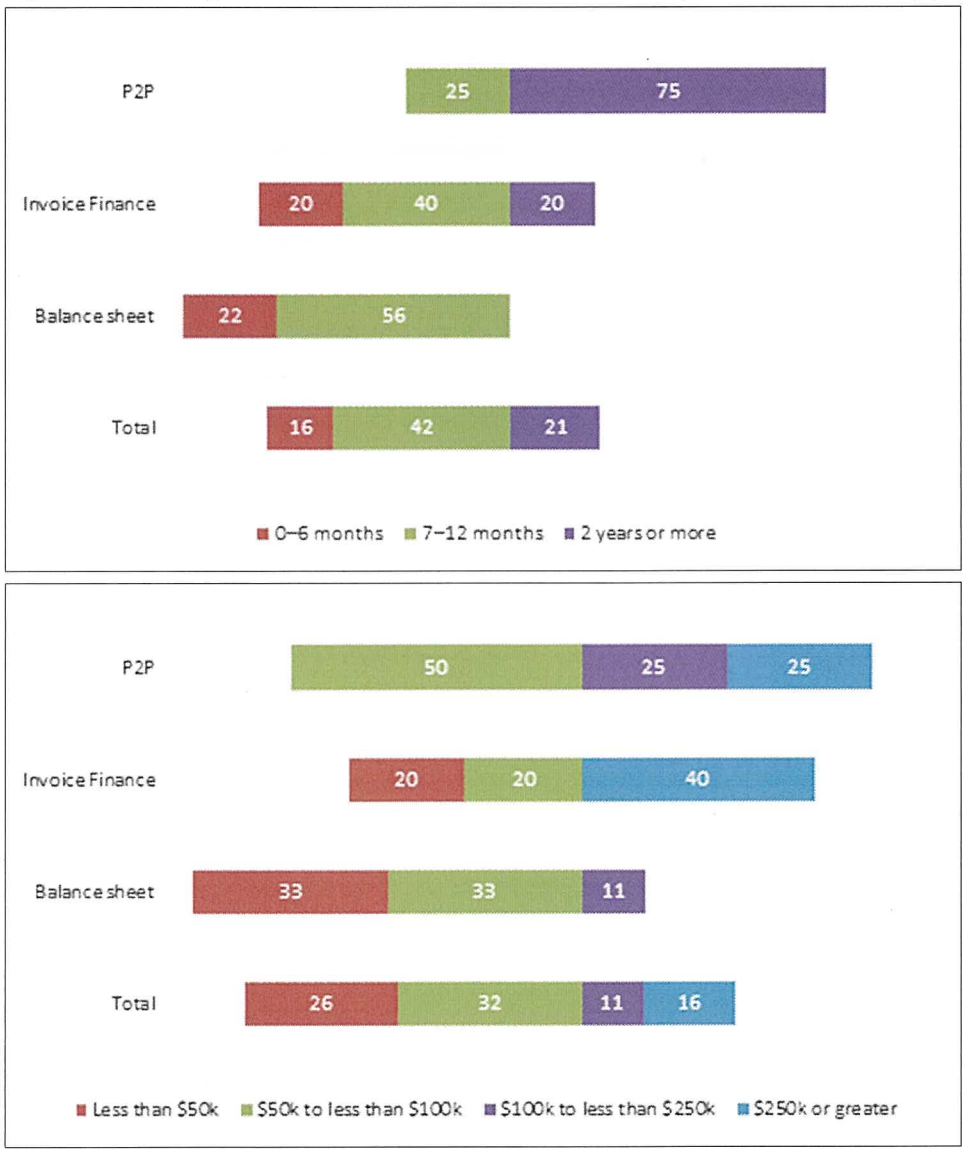
Survey Question 3: What products do you offer? Select as many as apply
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

Regarding loan term, almost three in five surveyed lenders indicated the majority of their lending is for terms of 12 months or less, with 42% selecting 7-12 months as their lending 'sweet spot'[33]. By lender type, surveyed balance sheet lenders reported sweet spots of 12

[33] For the purposes of the survey, the term 'sweet spot' was taken to mean the amounts borrowers most frequently sought from a lender, not necessarily as the amount that a lender typically would like to lend – though this would likely have an impact on the amount a borrower would typically request based on marketing and awareness of the lender's offering.

months or less. In sharp contrast to balance sheet lenders, 75% of P2P lenders indicated a 'sweet spot' term of two years or more.

Figure 2 and 3: Typical loan terms and amounts for loans provided to SMEs by participants



Survey Question 4: What is your sweet spot based on term? Survey Question 5: What is your sweet spot based on amount?
Note: Results from the single broker respondent are not reported individually but are included in totals.
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

Regarding loan amount, 58% of surveyed lenders indicated the majority of their lending is for amounts under $100,000, with 32% of lenders selecting a loan amount between $50,000 and $100,000 as their lending 'sweet spot'.

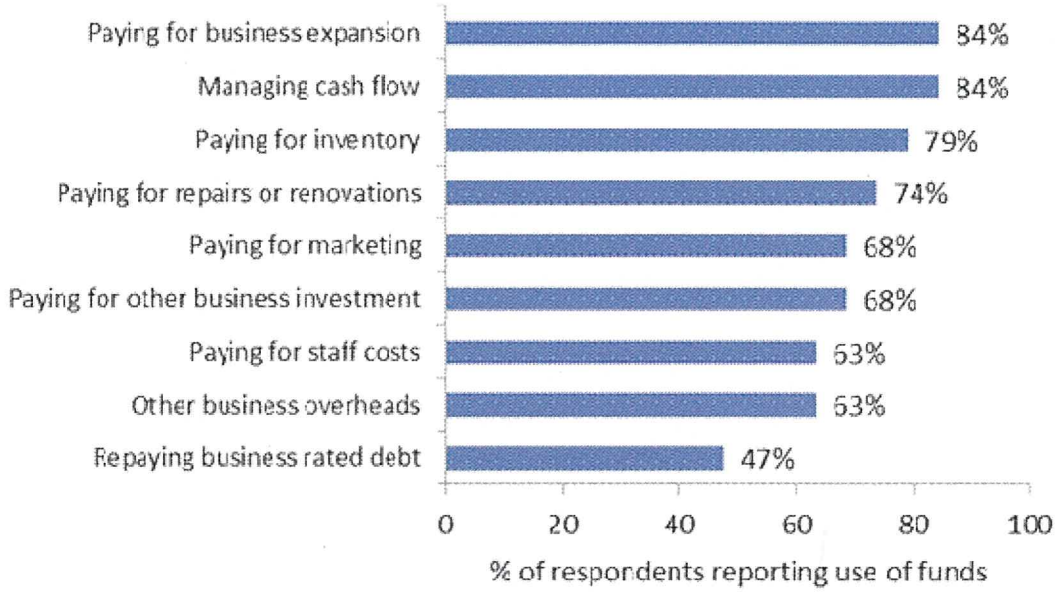
Some survey respondents pointed out that they engage in lending across a wide range of amounts and terms, notwithstanding an indicated 'sweet spot'. As such, customers seeking a loan term or amount outside a given lender's indicated 'sweet spot' could still find a compelling finance solution from that lender.

A lender's 'sweet spot' may also be influenced by their business model. Figures 2 and 3 highlight a tendency for P2P lenders to lend for longer terms and larger amounts than most balance sheet and invoice finance lenders.

Furthermore, SME demand can also be a determinant of 'sweet spot'. Fintech business lending tends to be shorter term (3-12 months) and the majority of finance is below $100,000, simply because small and medium-sized business owners are seeking loans to invest in areas where large capital amounts and long timeframes are not required. Figure 4 shows around 84% of surveyed fintechs reported that SMEs typically use funds for business expansion and managing cash flow. This was closely followed by paying for inventory or paying for repairs or renovations.

There were some disparities with how the different types of lenders responded. All of the surveyed balance sheet and invoice finance lenders reported that funds were typically used by SMEs to manage cash flow, compared to half of surveyed P2P lenders. All of the surveyed balance sheet and P2P lenders reported that funds were typically used by SMEs to pay for business expansion and repairs or renovations, while invoice finance fintechs reported paying for repairs or renovations was the least likely use of funds.

Figure 4: Typical use of funds by SMEs



Survey Question 7: How are Funds typically used by SMEs that you lend to? Select as many as apply.
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

Some fintech lenders will consider providing services to SMEs in all industries (applications will be assessed on a case-by-case basis). Other fintech lenders have a list of industries (or segments within industries) they will not provide services to or that will require further scrutiny and approvals before services can be provided.

Survey results confirmed a high degree of consistency in industries lenders will not consider lending to. The majority of lenders seek to reduce their own risk by not lending to industries with:

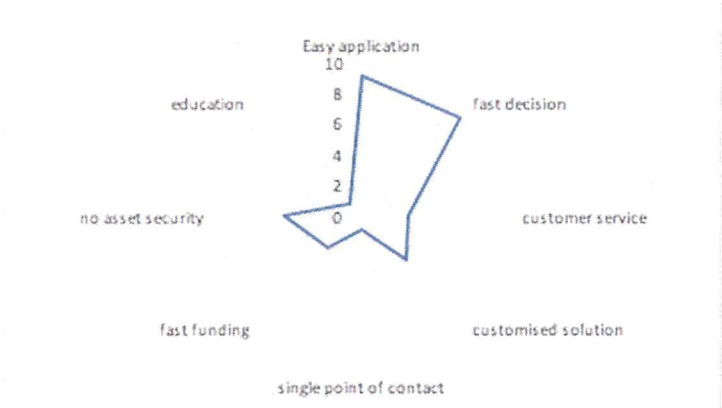
- known fraud, default or reputation risks such as weapons manufacturers, adult entertainment or gambling
- high volatility industries like construction
- businesses that do not suit the lending business model, such as primary industries where the cash flow cycle does not suit frequent (i.e. daily or weekly) repayments.

Further, 26% of respondents would not lend to other financial services providers. Two participants, both P2P lenders, were industry neutral; two invoice finance providers noted their clients are business-to-business (B2B) by default.

Why choose a fintech business lender?

Participants were asked to describe how their product experience differs to a bank issued loan product. Responses were focused on two key areas: 'ease of application', and 'fast decision' – both important factors for SMEs seeking relatively small loans and short terms. The "no asset security" feature was also mentioned by 26% of participants, also relevant to SMEs, which tend to be asset light (i.e. with few physical assets to offer as security), particularly those operating in the services sector.

Figure 5: How participants describe their product experience is different to a bank-issued loan product



Survey Question 8: How is your customer experience different to a bank issued loan product (Open response).
Source: Fintech Lending to SMEs Survey 2017 (n = 17).

Other features mentioned by participants included:

> *"Real people to talk to and obtain guidance. Refer to other businesses if our product type is inappropriate. Try to help the customer and provide a value added service. Return telephone calls. Accept telephone calls. All staff are domestic, and do work in call centres."*

> *"Application process is designed with the time-poor SME in mind. It is an online form which is simple to understand and takes approximately 5 minutes to complete."*

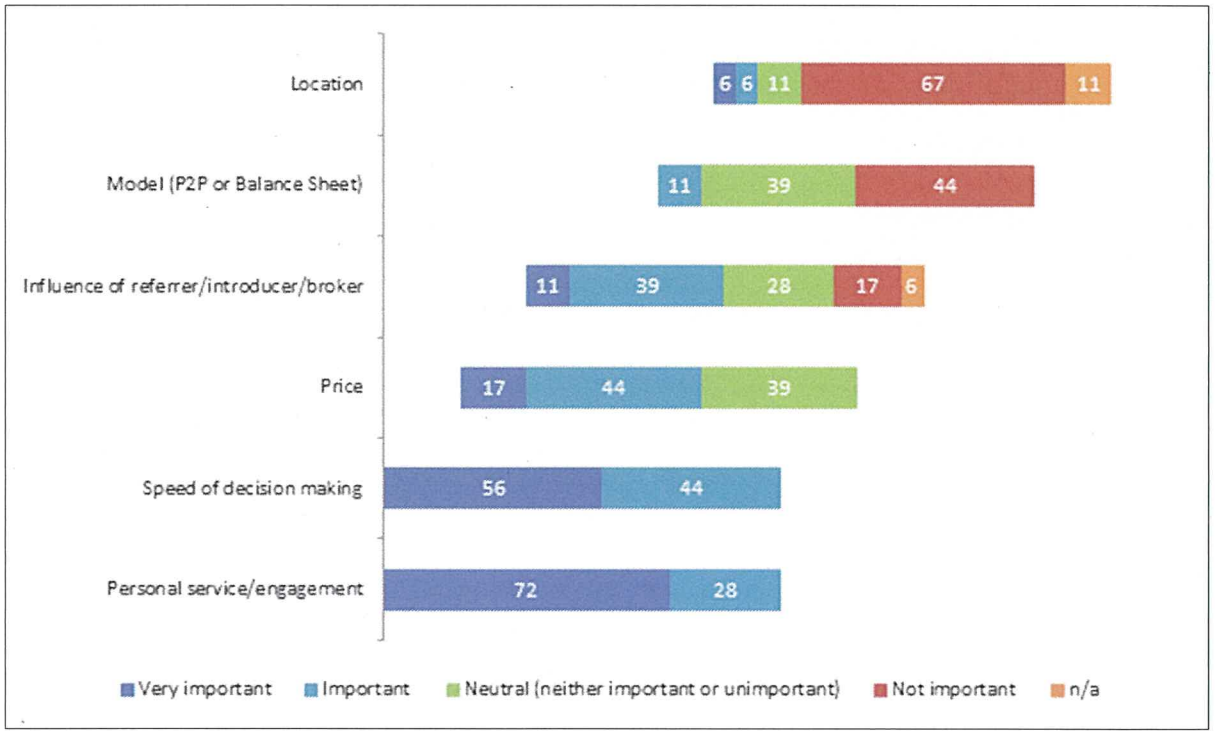
"Process takes about 30 minutes from start to finish, meaning in >95% of cases the business owner receives a response in under 24 hours. This is critical to the business owner who has plans for the capital and can't wait 2-6 weeks to get a response from the bank."

Participants were asked to rate how important they understood a range of factors to be for SMEs deciding to borrow from them. Fintech lending by nature is online and therefore 'location' was rated as being the least important factor when customers make a decision to borrow from them. However it was notable that 'personal service/engagement' was still considered important (100% of respondents rated it as 'very important' or 'important', with 68% of these rating it 'very important'). This is evident from the many fintech business lenders who mix some level of customer service engagement as part of their online processes.

Respondents also considered the business model of the lender either not important, or a neutral factor. Price was viewed as important or neutral – no lenders saw it as not being important. All of those who saw price as very important were P2P lenders.

Participants also recognised the influence of referrers/introducers/brokers, although this factor was less important to invoice finance providers.

Figure 6: Why customers choose to borrow from fintech business lenders, % of respondents reporting each factor



Survey Question 9: Why do you think your customers choose to do business with you? Rate how important you think the following factors are in the decision of your customers to borrow from you.
Source: Fintech Lending to SMEs Survey 2017 (n = 18).

These findings highlight both the opportunity and challenge for fintech business lenders. Fintech lenders offer a solution that is significantly different to that of a traditional lender –

they have identified a strong point of differentiation to traditional bank solutions in meeting SMEs' expectations for seamless online application processes and rapid credit decisions. Once a SME decides to use a fintech lender, the competitive set for evaluation changes to other fintech lenders, and consideration factors change to personal service and price. To a SME, the funding source and business model is irrelevant; they are simply seeking access to finance. As such, it would appear to most uninformed SMEs that all fintech lenders offer very similar solutions.

Fintech lenders are changing customer expectations; setting higher benchmarks for customer experience. However, they are still struggling to establish any dominance against traditional lenders.

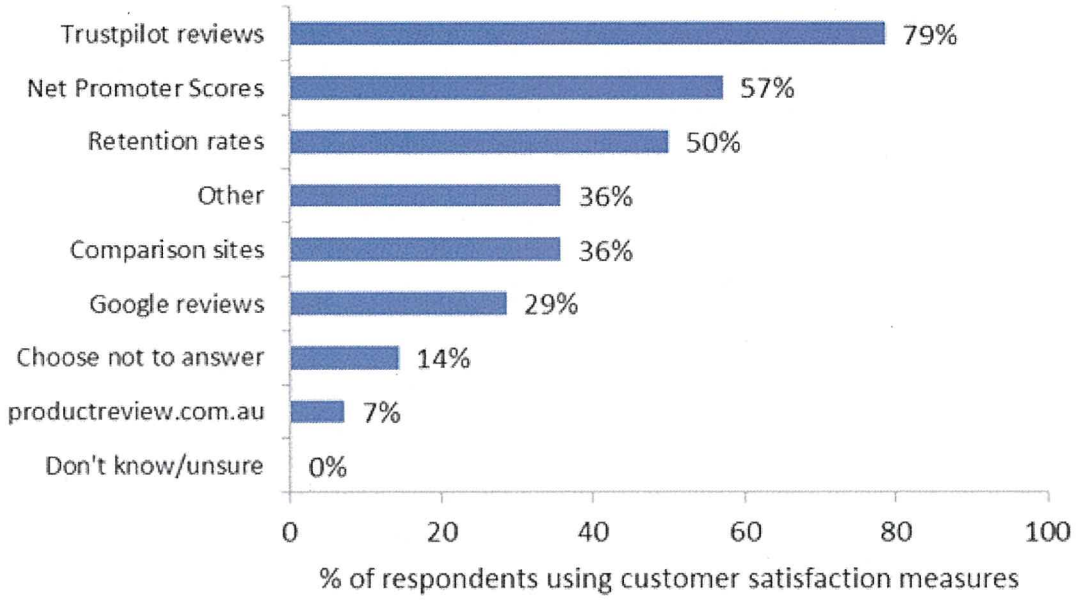
The total lending volumes from the fintech business lending sector still only represent a tiny fraction of total business lending in Australia. The rapid growth of the sector in the past four years appears to indicate the number of SMEs starting to leverage fintech business lending over traditional bank lending is also increasing – though it is not yet at a rate for the sector to develop significant market share within the next few years.

Promotion of lending products to SMEs

Independent review platforms (TrustPilot or YotPo, for example) are the most widely used measure of customer satisfaction, with 61% of participants indicating it is one of the measures they apply. 44% of respondents use Bain and Company's Net Promoter Score (NPS)[34] to gauge customer satisfaction and loyalty, and for balance sheet lenders this rises to 75% of respondents.

Figure 7: Measures of customer satisfaction used and publicised by participants

[34] Net promoter provides a score of customer experience. Net promoter scores are calculated as the net balance between the percentage of customers who are unhappy with a business and the percentage of customers who are enthusiastic about the business (passive customers do not feature in the calculation). Net Promoter scores can range from -100 (if every customer is unhappy about the business) to +100 (if every customer is enthusiastic about the business).



Survey Question 10: How do you measure and publicise customer satisfaction? Select as many as apply.
Source: Fintech Lending to SMEs Survey 2017 (n = 14).

All respondents using NPS were also asked to provide their NPS scores. These self-reported scores ranged between 40 and 80, a significantly higher score than the traditional big four banks, whose NPS scores are all negative[35]. The widespread use of TrustPilot in particular, given its independence and relatively high cost, further indicates the confidence fintech business lenders have in their customer experience and their ability to attract positive reviews.

The survey also highlights there are no common measures of customer satisfaction between fintech business lenders – though this is also true of the banking and even the financial services sector more broadly. NPS is widely used, but not mandatory. NPS scores can also be manipulated by asking certain customer segments and not others. TrustPilot would provide a common methodology and independence, however its high cost ($1,000 per month) would be unaffordable to smaller startup fintech business lenders.

Transparency and disclosure of fees

Prior to the survey, many of FinTech Australia's fintech business lending members had already convened in an effort to develop a standard set of definitions and cost calculations for common terms related to fees and disclosure. This coordinated effort was undertaken as a proactive measure to help improve SMEs' understanding of these terms, and a first step toward developing a responsible self-regulatory framework, including a more standardised disclosure regime for the nascent fintech business lending industry.

[35] Roy Morgan Single Source (Australia), 6 months ended April 2017

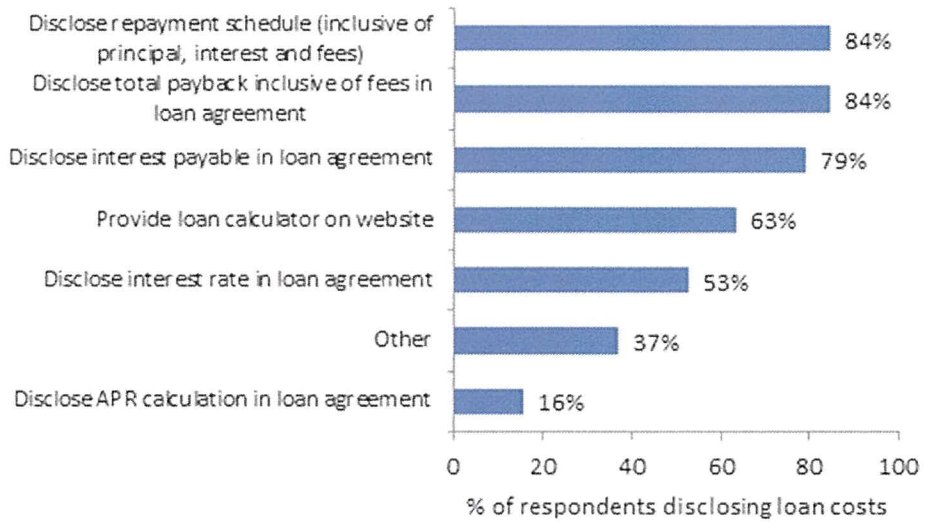
The initial *Glossary of Common Lending Terms* was provided along with the survey to all participants to ensure a common understanding for responses relating to fees and disclosure, including metrics such as Annual Percentage Rates (APRs – which in the context of this report is taken to mean interest rate plus other costs as a comparison rate as defined in the Glossary, rather than just the interest rate alone as it is in the UK).

Participants were asked what steps they take to ensure borrowers can readily calculate and understand the cost of a finance agreement. Often borrowers are required to make a decision based on information on the websites, which may include a loan calculator.

As a result, the actual fee structure may only become fully apparent when a borrower sees the Loan Agreement. The survey responses showed that 84% of lenders disclosed in their loan agreements the total amount to be paid back together with a repayment schedule. Around four in five lenders disclosed the total interest payable as a separate amount in the loan agreement, while 15% disclosed the APR in the loan agreement.

This highlights the large variation in methods for calculating and disclosing the cost of loans offered by fintech business lenders. The disclosure of different key metrics and rates (APR or otherwise) by fintech lenders and the different methodologies for calculating those metrics and rates has implications for the ability of SMEs to compare products from fintech business lenders and other lenders.

Figure 8: Steps taken to ensure borrowers can readily work out lifetime cost of a loan

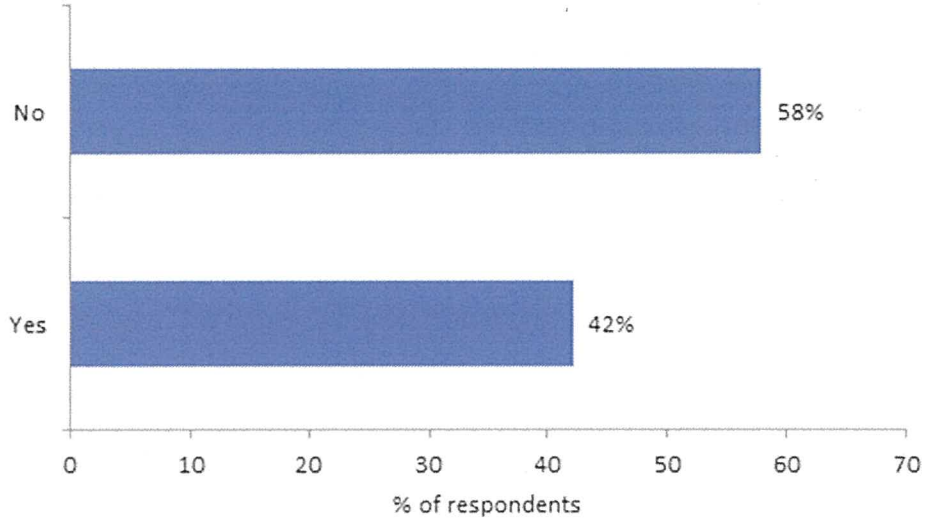


Survey Question 12: What steps do you take to ensure borrowers can readily work out exactly how much a loan is going to coast over the life of the loan? Select as many as apply.
Note: Question 20 in the survey also asked if the respondents had a loan calculator on their website to which an additional three fintechs responded "yes". Without further information from respondents, it is unclear if the discrepancy is indicative that some loan calculators do not assist borrowers to work out the lifetime cost of a loan or if it is due to respondent error.
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

Participants were asked if they charged direct debit fees. Excluding the broker, two of the balance sheet lenders said yes, all other respondents (84%) said 'no'. When asked if

borrowers can choose their repayment frequency to reduce the cost of fees and better suit their cash flow, 58% said 'no' (see Figure 14).

Figure 9: Flexible repayment frequencies offered to reduce the impost of direct debit fees and better suit cashflow



Survey Question 14: Can borrowers choose the repayment frequency to reduce the impost of these fees and to better suit their cash flow?
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

However, the question itself is difficult to answer, as the two parts may in fact contradict each other. Feedback from some customers suggests that more frequent repayments help them manage their cash flow better than one large monthly repayment. For example, a small payment automatically deducted from the daily takings of a cafe can be easier to manage than one large monthly repayment. Choosing repayment frequency is also irrelevant to the cost incurred if the lender does not charge direct debit fees – of the two lenders charging direct debit fees, only one does not allow for a choice of repayment frequency.

More frequent repayments aligns with the nature of cash flow lending and the risk policies of fintech lenders; frequent repayments help lenders manage risk because customers having trouble with repayments are identified quickly. This means the lender can proactively inquire with the SME customer, and suspend payments if necessary before overdue fees accrue. Additionally, this data can inform future risk models.

The above also begins to highlight a central point regarding how business model and product differences, including responsible lending requirements for licensed lenders, may influence a fintech lender's treatment of and flexibility with fees.

At the heart of SME lending business models are critical questions of product design – particularly in how loans (and fees) are capitalised, and how they are amortised. Some finance products work more like mortgages, where the total anticipated cost of the loan plus interest is calculated as a lump sum based on a specific loan duration, which is then paid down over that specific duration by the borrower. Such loans are not designed to be flexible,

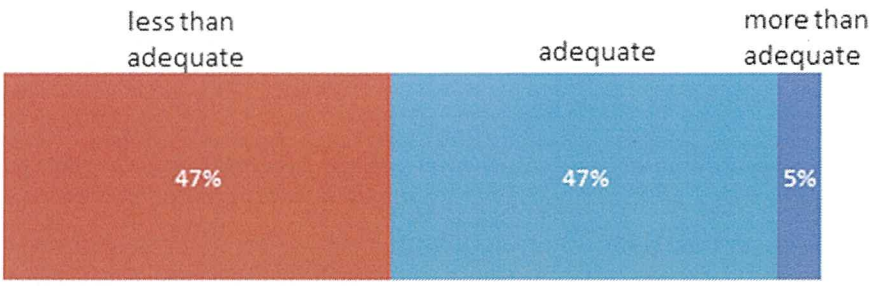
as the lender enters into the loan agreement with an understanding that they will have certainty over repayments and total return over time.

However, SMEs are increasingly seeking more flexible loan products, which has seen a dramatic rise in demand for invoice financing and other merchant cash advance type solutions. Uncertain operating environments and factors such as seasonality can result in lumpy cash flows for many SMEs, and makes it impossible to forecast capital requirements over a fixed loan term. In such cases, SMEs may be happy to pay a higher interest rate in exchange for greater flexibility in term and repayment amount.

Is there sufficient transparency and disclosure of fees?

Fintechs who lend to SMEs have very different views about the current levels of transparency in their sector. When asked whether the fintech lending sector's overall level of fee transparency and disclosure was adequate, opinion was roughly divided 50:50, though responses were highly correlated to business model.

Figure 10: Opinion of the FinTech lending sector's overall level of fee transparency and disclosure

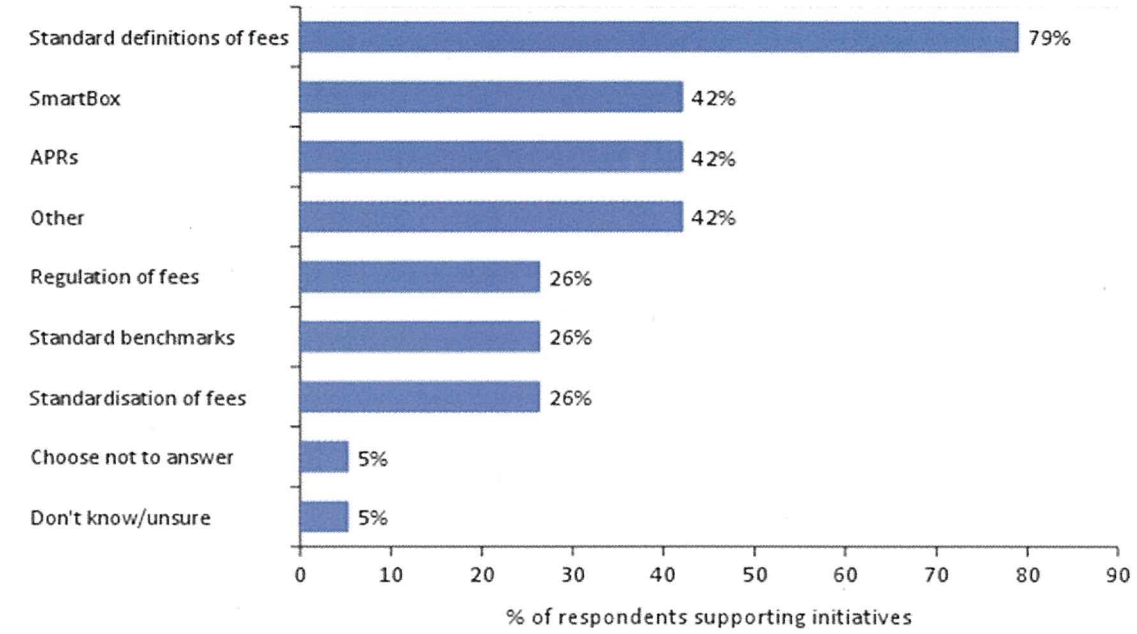


Survey Question 15: In your opinion, is the Fintech lending sector's overall level of fee transparency and disclosure...
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

All P2P lenders who responded to the survey reported the overall level of fee transparency in the sector as 'less than adequate'. Opinions of balance sheet and invoice finance fintechs were split, although slightly in favour of reporting 'adequate' fee transparency in the sector.

The way that fees, interest rates and other items are disclosed is just as important as whether they are disclosed at all. In order for loan costs to be understood and compared easily, loan agreements and other documents disclosing these items need to be written in 'plain English' and use consistent terminology that has the same meaning across different providers. Standard definitions of fees across the industry were supported by 79% of respondents (Figure 11). The high level of support for this measure might be related to the work already carried out by a number of fintech lenders to develop an industry-specific standard set of definitions.

Figure 11: Proportion of respondents supporting initiatives to improve fee transparency



Survey Question 16: Would you or do you support the following initiatives? Select as many as apply.
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

The results indicate there is no clear consensus from participants on the best way to improve transparency except for the provision of standard definitions. Those disagreeing or choosing not to answer were: one of eight balance sheet lenders, the broker (don't know/unsure) and two of five invoice finance providers. One invoice finance provider chose not to answer this question.

There is also a clear difference in appetite for some initiatives based on lender category. 75% of P2P lenders would support standardisation of fees, but none of the balance sheet lenders would. All of the P2P lenders would support the use of APRs, and 75% would support SmartBox usage. The only broker to complete the survey did not choose any measure and said they were unsure.

Respondents commented that fintech business lenders operate in a much wider market, including financial institutions such as banks, equipment leasing companies, debtor finance organisations, and other listed and private SME finance groups. Some felt that if the goal was to help SMEs make better decisions about their financial options, it was important commercial lending products were seen in totality and not in isolation, to ensure a greater understanding for SMEs across all their finance options.

> *"The definitions, benchmarks and related regulation must be broad enough to apply to all non-bank SME Lenders."*

Respondents were split about regulation in relation to which fees fintechs can and cannot charge. Most respondents took 'regulation' in this question to mean 'government regulation'. While a quarter of respondents viewed regulation as an option, a number of the 'other'

responses were concerns that regulation would hamper the ability of industry participants to develop a sustainable business, especially if standardisation was mandated by regulation.

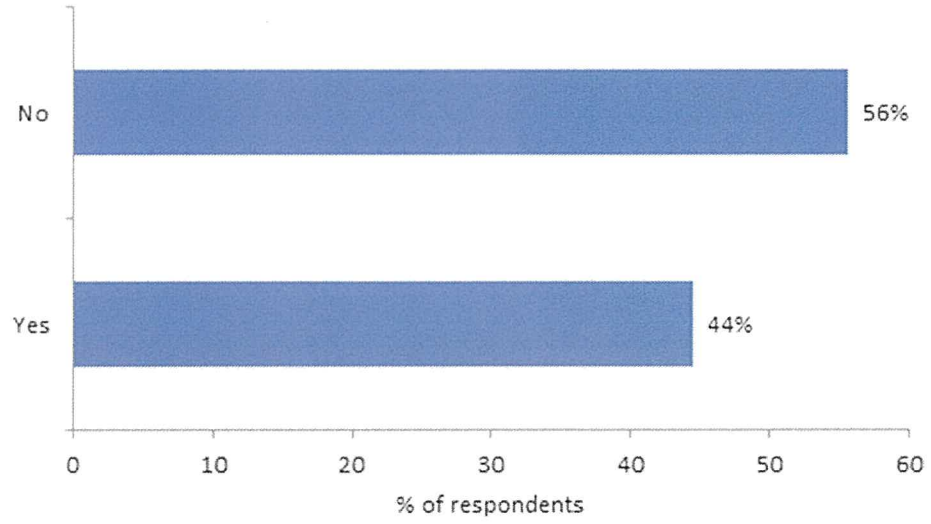
> *"If the FinTech industry is too regulated it will lose the entrepreneurial edge and become standardised. This will result in the industry being regulated back to a more traditional model."*

Industry self-regulation appears to be more palatable to the sector but 'must be broad enough' to apply to the range of differing business models in the fintech lending industry.

The role and use of brokers

Just over half of the lender participants do not disclose details of any fees or commissions paid to introducers (including SME advisors), brokers and partners. One participant declined to answer.

Figure 12: Participants disclosing to borrowers details of any fees, commissions paid to introducers/brokers/partners



Survey Question 17: Do you disclose to borrowers details of any fees, commissions, etc paid to introducers/brokers/partners?
Source: Fintech Lending to SMEs Survey 2017 (n = 18).

Of those who answered 'yes' to disclosing broker fees/commissions, the commissions they paid covered a range of methodologies and amounts, ranging from basis points on the interest rate charged to a percentage of the settled amount, drawdown fee or invoice value.

Some of those who answered 'no' to broker fee disclosure did so because they did not pass on the fees to the customer.

> *"We pay brokerage and commissions to accountants and brokers but it is deducted from our application fee of 1.5%. We have no other fees. So our business is incurring the cost as part of the client acquisition cost."*

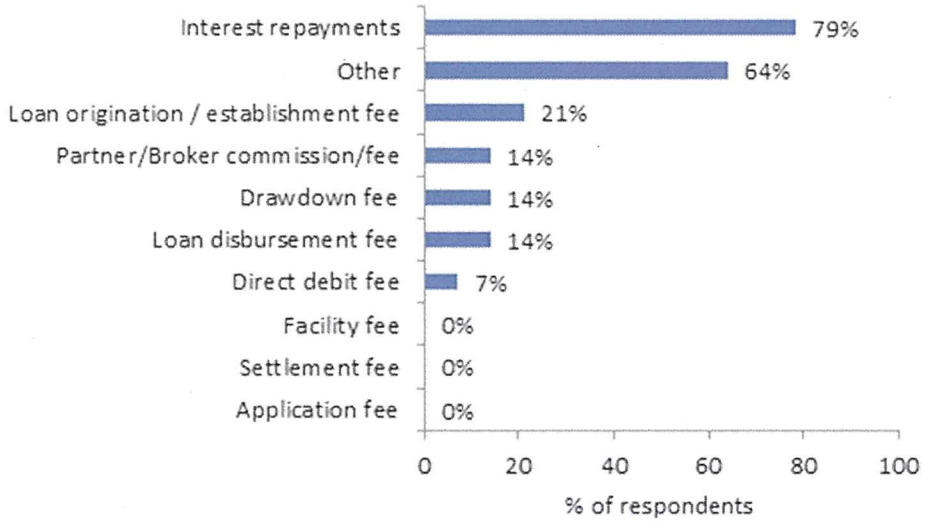
Using a fintech broker can help an SME make a decision about the various loan options available. However, different commission structures may also create adverse incentives. Commission paid to introducers/brokers can range from 0.25% to 4% of the loan amount and sometimes even more. This has the potential to make it more attractive to introduce potential borrowers to those lenders that pay the highest commission. Commission arrangements could also encourage "churning" of borrowers. Exclusive referral agreements can also distort the information provided by brokers to SMEs. It should be noted that finance brokers are bound by a code of practice administered by the Mortgage and Finance Association of Australia (MFAA) that requires them to arrange appropriate finance and disclose commissions to customers[36]. Different state and territory laws may also apply to an introducer's commission.

The role and use of loan calculators

Loan calculators are generally used by SMEs to estimate the total cost of a loan or to estimate repayments. They can also be used by SMEs to compare different loan options, provided the underlying structure is consistent. However, the wide variation in the structure of loan calculators, as well as the variation in the treatment of fees and duration, can hamper the reliability of their role as a comparative tool. Loan calculators can create complexities for lenders who use a rate-for-risk model, as the calculator comes pre-application and therefore cannot take the customer's specific situation into account.

Only 57% of those with a loan calculator quote an interest rate in the calculator. Some lenders also include various fees in their calculator, and some do not. Only 21% of lenders include loan origination/establishment fees, and fewer include other fees like drawdown fees, direct debit fees and other variable product costs.

Figure 13: Fees included in loan calculators



[36]Mortgage and Finance Association of Australia, 2016, Code of Practice, https://www.mfaa.com.au/sites/default/files/About%20Library/MFAA%20Code%20of%20Practice%20160904.pdf

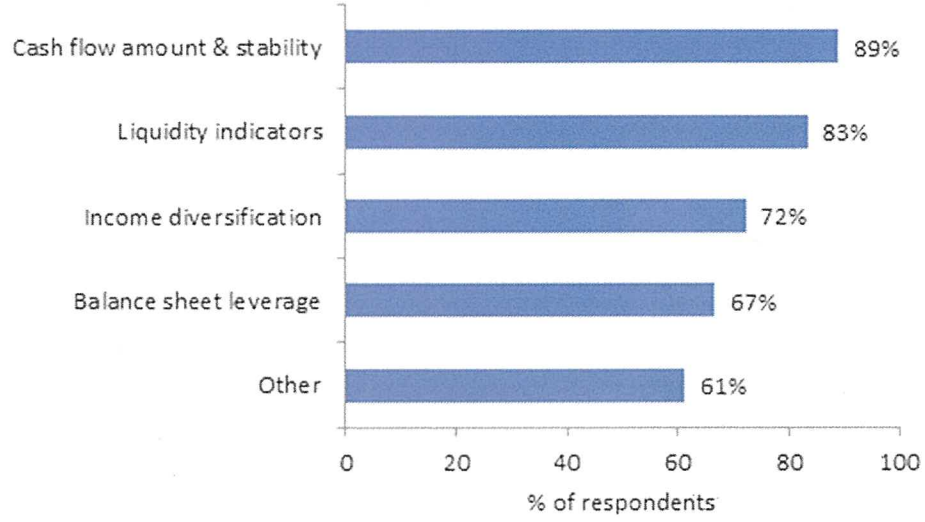
Survey Question 21: If Yes, what fees are included in your calculation of the rates and repayments? Select as many as apply.
Source: Fintech Lending to SMEs Survey 2017 (n = 14).

All of the P2P lenders include a loan calculator on their site, though in line with other participants, there is little consistency in the fees they include.

The responsibilities of lenders

Most lenders use similar metrics and categories of analysis to assess and verify a SME's ability to service a lending product, including cash flow amount and stability, income diversification, balance sheet leverage and liquidity indicators. Invoice finance lenders tend to pay closer attention to the quality of the debtors and customer management. Unsurprisingly for fintech lenders, almost all use transaction data, credit bureau data, financial reports, ATO data and third party data sources.

Figure 14: Evidence used for considering the ability of SMEs to service loans



Survey Question 33: What do you consider when assessing an SMEs ability to service a lending product?
Source: Fintech Lending to SMEs Survey 2017 (n = 18).

Fintech lenders are clearly effective users of many types and sources of data to ensure both accuracy and efficiency of their credit decision processes. This enables lenders to underwrite applications from SMEs whose risks could not previously be assessed, and reduce underwriting costs by automating the collection and analysis of key data (e.g. data collected directly from a cloud accounting platform).

Lending to SMEs who have already obtained credit from a competitor

The practice of lending to a customer who already has a loan with a competitor, known in the industry as 'loan stacking', is a risk factor that each lender looks at differently.

> *"The vast majority of Australian SMEs have multiple sources of commercial and consumer credit. This includes one or several of business asset/equipment finance, credit card(s), overdrafts, vehicle fleet finance, trade creditor finance, supply chain/inventory finance etc.*

Serviceability must be considered taking into account the full picture of liabilities from various sources."

Over three in five surveyed lenders would lend to a business a competitor had already lent to or extended credit to. Most lenders look at all outgoings, i.e. a full cash flow analysis before determining the creditworthiness of a borrower including payments to other finance providers. However, several lenders also required a form of debt buyout from their competitor before proceeding, though this is not always possible if the existing loans are subject to lock-in/termination provisions. An additional obstacle often encountered relates to overly broad All Asset Security Interests (General Security Agreements) held by existing lenders, particularly banks and leasing companies. SMEs may at times be unaware of the implications until they approach new lenders.

Unfair Contract Terms

Changes to Australian Consumer Law have meant that small business loans have been protected from unfair contract terms since 12 November 2016.

The survey has shown that all lenders are aware of the update to Consumer Laws regarding the expansion of Unfair Contract Terms to Small Business. Around 50% of lenders changed their contracts to comply with the legislation.

Around four in five survey participants stated they do not have the right to change any terms when a borrower is meeting all financial commitments.[37] Those that answered 'yes' (one balance sheet lender and two P2P lenders[38]) could make changes to the amount or method of calculation of a fee (such as a late fee) or the amount, number, frequency and/or time of repayments – though this could not affect the total payback, interest rate, or interest payable by the SME. Of the three respondents who could make changes to terms, two respondents gave 30 days' notice while the other respondent gave 20 days' notice.

In relation to providing notice to rectify a breach, before enforcement action is taken, there were widely diverging views ranging from seven days to 60 days depending on the nature of the breach. Overall, surveyed fintech lenders seemed to be consistent in that they wanted to work with borrowers to assist them to repay their loan, and saw enforcement options as a very last resort.

Loan contracts varied widely in length, from six to 43 pages. Part of this variation was due to the different attachments included with the contract[39], and different font sizes and formatting.

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[37] Survey Question 40: Do you have the right to change any terms when a borrower is meeting all financial commitments?

[38] Report writers modified one survey respondent's "yes" response to a "no" after reviewing responses to Survey Question 41: If yes, what terms can you change? (Open response). It was clear to the report writers that this respondent did not make changes to terms.

[39] For instance, unsecured term loans generally require less documentation compared to invoice finance due to the Personal Property Securities Act 2009.

FinTech Australia notes that many of the survey participants include a single page cover sheet detailing key elements of the loan contract in line with international best practice.

Figure 15: Page length of standard loan contract

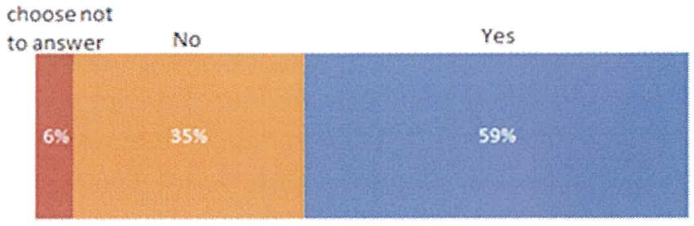
0-10pp	11-20pp	21-30pp	31-40pp	41+
3	6	5		2

Survey Question 44: How many pages is your standard loan contract for your key SME lending product, including all additional documents (such as general terms and conditions) that make up the overall contract? (Open response)
Source: Fintech Lending to SMEs Survey 2017 (n = 17).

ASIC and the ASBFEO recently worked closely with the big four banks, which led to changes by the banks to significantly reduce the risk of unfair contract terms in their small business loan contracts. One area of concern was the use of non-monetary default clauses such as 'material adverse changes'[40] in contracts where they provide for loan 'default' in a very broad range of circumstances, rather than where the borrower has materially defaulted on their obligations.

Fintech business lenders were not surveyed to understand specifically what types of events might trigger a non-monetary default, but almost three-fifths of respondents included non-monetary default clauses in their loan agreements.

Figure 16: The inclusion of non-monetary default clauses in loan contracts



Survey Question 45: Does your loan documentation include non-monetary default clauses such as Material Adverse Changes?
Source: Fintech Lending to SMEs Survey 2017 (n = 17).

Lending practices and principles

The survey asked fintech lenders what their general lending practices or principles include[41]. From the variety of responses received, it is clear that while many lenders take various steps to implement standard lending practices and principles, there is no consistency in how they should be applied. This was also highlighted by the concerns outlined in the previous section on unfair contract terms.

Measures undertaken by surveyed fintech lenders to implement lending practices and principles include:

[40] Material adverse changes allow lenders to call a default for an unspecified negative change in the borrower's circumstances, even where the borrower is meeting their financial obligations in full and on time.
[41] Survey Question 32: What do your general responsible lending practices or principles include? (Open response).

- obtaining an Australian Credit Licence from ASIC
- following their own code of Business Conduct and Ethics
- meeting the National Credit Code for consumer lending
- creating their own guidelines for Information Security, ID Theft Prevention, Customer Complaints, Fair Lending, Credit policies
- ensuring loan serviceability is a key component of the credit decision model.

There are a myriad of different requirements that may apply from a number of different government departments and agencies, but the exact legal, regulatory and responsible lending obligations are unclear for fintech lenders.

Greater clarity may be needed from regulators concerning lending rules and practices for fintech lenders, including consequences for non-compliance, to ensure any existing and new entrants can easily find and understand their obligations, and how to adhere to them. These obligations need to take into account different fintech lending models, the size and scale of the lender's business, the size and scale of the fintech lending sector relative to the overall market and the risk/benefit to SMEs of having access to finance.

Default and debt collection practices

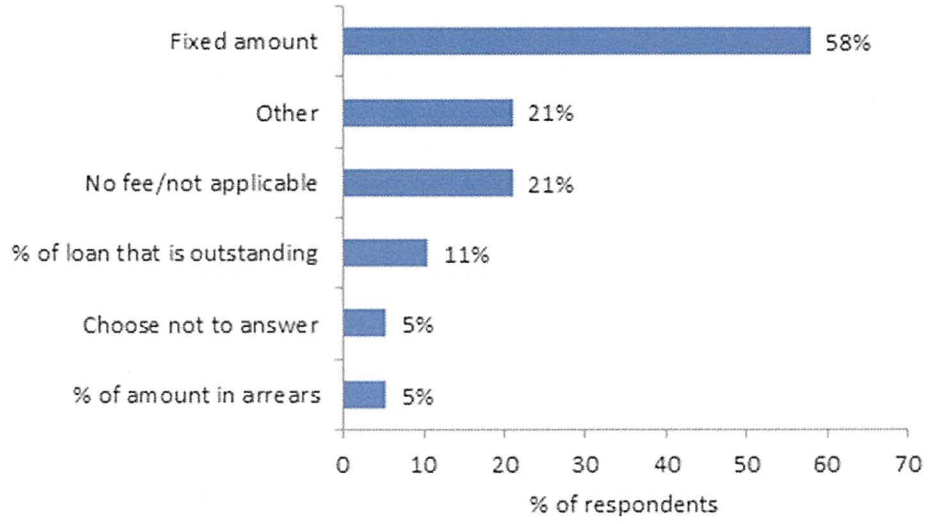
Things do not always go as planned for SME owners, and they sometimes find themselves unable to make loan repayment schedules as committed.

Competition and consumer choice in the industry can depend on how easy it is to exit a loan, or to switch lenders. With cash flow also an issue for many SMEs, a lender's debt collection practices when a loan payment is missed can be an important consideration when deciding what loan product is right for them.

Penalties

Survey responses confirm that different business models determine whether dishonour fees are charged, and how they are applied. 79% of lenders charge dishonour fees – and all of those that do not are invoice finance lenders (though one invoice finance provider declined to answer). Of those that charge dishonour fees, all balance sheet lenders charge a fixed amount and half of the P2P lenders charge a fixed amount.

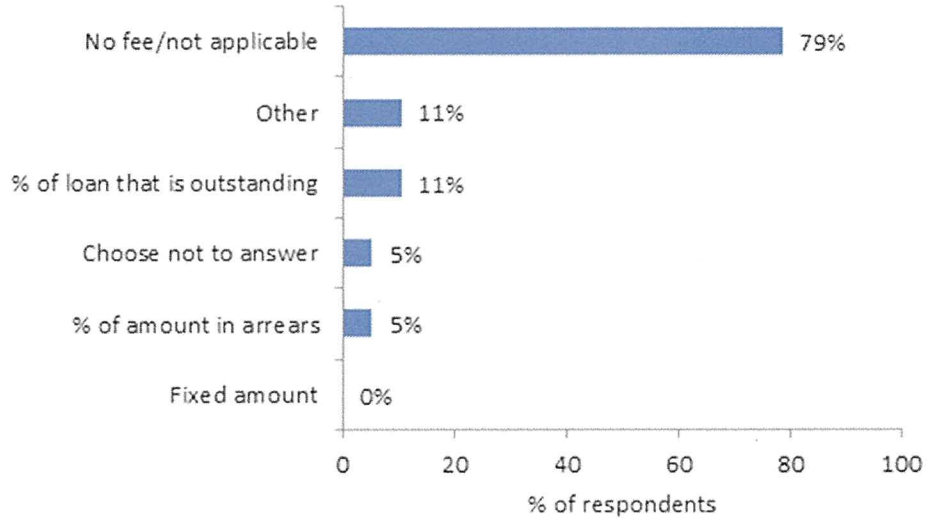
Figure 17: How direct debit dishonour fees are charged



Survey Question 23: How do you charge direct debit dishonour fees?
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

Almost four in five of surveyed lenders do not charge loan extension fees when a borrower misses a payment, with one lender declining to answer and another saying it depended on the circumstances of the borrower.

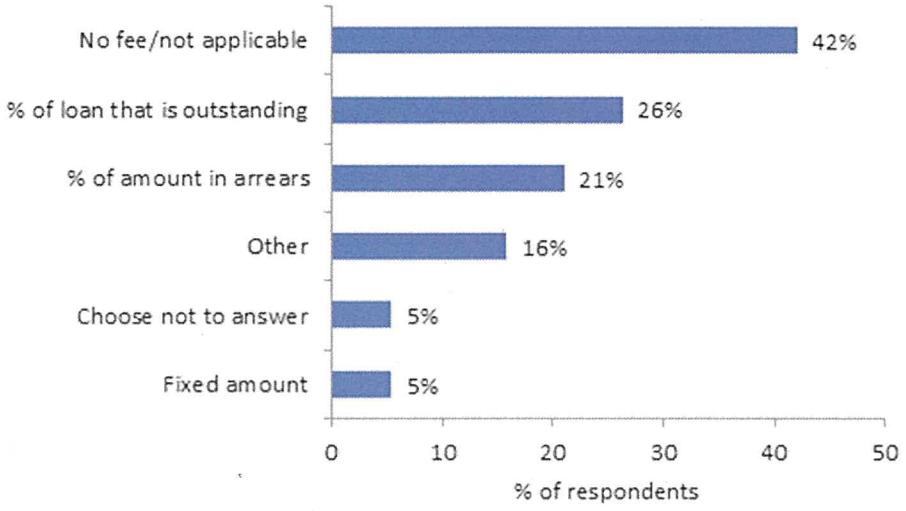
Figure 18: How loan extension fees are charged



Survey Question 24: How do you charge loan extension fees?
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

When it comes to charging for late payment, again there are differences based on the business model. All except one of the balance sheet lenders charge for late payment. However, all but one of the invoice finance providers, and all but one of the P2P lenders, do not charge for late payment.

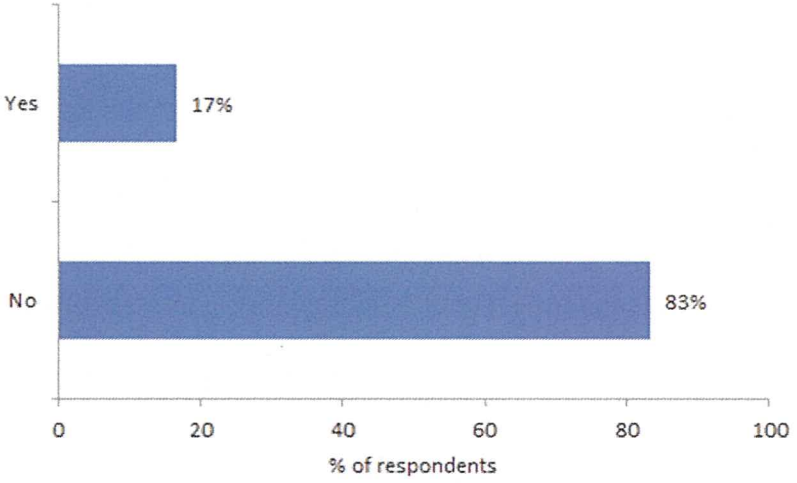
Figure: 19: How late payment interest is charged



Survey question 25: How do you charge late payment interest?
Source: Fintech Lending to SMEs Survey 2017 (n = 19).

When a borrower misses a payment, 83% of lenders charge no other fee. Those that do charge additional fees specified that these extra charges were only legal or other enforcement costs, or a fee for loan rescheduling.

Figure 20: Are any other fees* charges when a borrower misses a payment?



Survey question 26: Do you charge any other fees when a borrower misses a payment?
Source: Fintech Lending to SMEs Survey 2017 (n = 18).
* Other than late payments fees already surveyed.

Early pay-out

Fintech lenders were surveyed about fees they charge on early termination or payout. The majority of lenders (84%) reported they do not charge fees of any kind for early repayment or for early exit/discharge. This result can be misleading as there can be requirements to pay the full contracted interest amount of the loan on early repayment. Some 80% of lenders adjust the interest charges in case of prepayments, so the total amount payable by the

borrower is only based on the number of days the principal is outstanding; 20% do not do this.

For example, a fintech lender has offered a small business a loan of $20,000 to be repaid over eight months. The contract says interest of $5,240 is payable. If the small business wanted to pay out the loan before expiry, this could be done at any time provided the total contracted interest amount of $5,240 was paid in full. So even though there are technically no 'fees' for early repayment, there are financial consequences that need to be made transparent to SMEs.

Requiring full payment of interest is also a barrier for SMEs wanting to refinance their loan with another lender. For example, theBankDoctor.org tells of a report from a small business owner who realising they were paying a high rate of interest, wanted to refinance with another lender at a much lower rate only to find they were locked into paying the full amount of interest contracted.

Many of the surveyed lenders did however offer a discount on remaining interest, though comments were made about how discounts were applied to interest, and whether this was fully understood by SMEs:

> *"Many lenders will state 'get a discount for repaying early'...however it is a discount to the full interest payable over the contract, not a pro-rata of interest to the point of repayment. These are two very different things."*

Business model differences also play a role in the way early pay-outs are treated. As outlined earlier, some fintech lenders capitalise establishment and other fees into the loan principal, with these fees (plus interest) amortised over the course of the loan. In such cases, early pay-out fees can also take into consideration not only the lost interest, but also the upfront fees that were expected to be paid. Other business models provide for products that act more like a Merchant Cash advance, and allow the borrower to have greater flexibility with no resultant early pay-out fees in exchange for a higher or more variable interest rate.

While 100% of lenders stated the borrower receives clear information about loan termination, this is an area where improvement in terminology and greater understanding of how products might differ between lenders will make it easier for SMEs to fully understand the information that is being presented to them, and how to compare between different lenders – particularly given business model factors.

Lenders should ensure it is clear to borrowers whether they are getting a discount on the full interest payable over the contract or whether the pro-rata interest to the point of repayment is waived. Clearer and more comprehensive definitions of exit/discharge/early termination fees are needed to assist borrowers' understanding.

Regulation and complaints handling

An important part of building trust for lenders is ensuring customers have a means of escalating and resolving any disputes. As such, 61% of fintech business lenders are already members of an External Dispute Resolution (EDR) service – though it is notable that some respondents are only newly launched or in pre-launch stage. It should be noted that fintechs that lend to SMEs are currently not required to meet any EDR and IDR requirements.

Respondents also indicated they are very supportive of a lending charter to improve transparency and standards, with 89% stating they would sign up. One of the two negative responses was from the broker.

Other than a voluntary charter, a number of respondents thought the fintech industry could improve transparency and standards by working through an industry group to develop policy, raise industry awareness, advocate, and undertake data collection and data sharing. Yet it was also noted that the issues were broader than just the fintech industry.

> *"We do not see fintech as a useful segmentation of the market as (a) it is highly subjective as to what constitutes a fintech lender vs a non fintech lender, (b) the issues raised in this survey apply equally to all lenders to SME, and (c) the current self described fintech lenders in the market are responsible for less than 1% of SME lending in Australia."*

There were also suggestions to:

- survey SMEs to get insight into their concerns and considerations around access to finance
- clearly define the category/terminology i.e. fintech lenders vs online SME lenders vs alternative lenders vs balance sheet lender/P2P/invoice finance
- collaborate with government and agencies to raise awareness and educate SMEs
- set up the equivalent of the British Business Bank, where government acts as a wholesale financier, and demonstrates trust in the sector
- set up a referral scheme for SMEs declined by banks.

Three of the four P2P lenders argued strongly in favour of greater transparency on fees and rates, and supported a standardised, industry-led disclosure cost of borrowing regime.

When asked to define the greatest challenges facing online SME lenders, three major issues stood out.

1. Low awareness with SMEs.
2. Lack of trust.
3. Cost of funds and acquisition, and thus an inability to achieve economies of scale.

A need for better industry collaboration was also described, as was the need for improved access to comprehensive credit reporting data, and more certainty and clarity around the regulatory environment.

"The challenges are lack of scale, lack of funding and high origination costs. For the larger, more established lenders the primary challenge revolves around transitioning to a large scale finance organization and institutionalizing risk, compliance, sales, operations, and funding."

"Ultimately the Australian FinTech industry is in its infancy and needs time to mature. It is the only viable long-term SME lending competitor to the Banks. A regulatory environment that encourages innovation and supports earlier stage companies is very important."

5. Industry self-regulation: Next steps

This report analyses responses from the various lenders to provide greater clarity, definition and context into the industry's approach to marketing, assessing and providing loans and to the fees that are charged along the way.

While it is clear that tremendous progress has already been made by fintechs, the research does highlight several areas where practices and processes need to be improved to create better outcomes for SMEs seeking to obtain a loan from fintech business lenders.

Industry self-regulation and industry action are required to provide adequate transparency and disclosure and to take the industry forward. Six key pillars for focusing industry self-regulation and action have been identified.

Industry roundtable discussion

On the 13 December 2017 a roundtable discussion was held to discuss report findings, the merits of the various approaches, and to prioritise and set timelines for initiatives that would standardise terminology, increase transparency and disclosure across the fintech business lending industry. Potential initiatives to help educate SMEs about different fintech lending products and options, and to drive greater awareness of the sector were also discussed.

Following the roundtable meeting, participants resolved that:

- FinTech Australia would finalise a glossary of terms to distribute with this report (covering unsecured small business loans, and potentially split for balance sheet versus peer-to-peer lending)
- an industry working group would be formed, which will consult with stakeholders to develop a Code of Conduct by June 2018 to cover fintech balance sheet lending for unsecured business loans that:
    - outlines best practice principles
    - is customer-centric and outlines what a customer can expect
    - prescribe the comparative measures such as APRs and total cost to be provided to potential borrowers
    - would be expanded upon in future to cover other loan products, on a product by product basis
- fintech business lenders would work with the ASBFEO to ensure they comply with the Unfair Contract Terms legislation
- ASBFEO would facilitate discussion between fintechs and the Australian Financial Complaints Authority to explore alternative external dispute resolution services in early 2018
- by June 2018 the industry working group would agree on a common set of plain English key terms and conditions to be highlighted in a summary page in all loan agreements
- ASBFEO and theBankDoctor.org would write an education piece for SMEs, in consultation with industry that will coincide with the outcomes from the actions above.

Compliance with unfair contract terms legislation

Small businesses do not have bargaining power when requesting changes to standard form contracts. Protection against unfair contract terms can help correct this balance, and changes were recently made to Australian Consumer Law to extend this protection specifically to SMEs. This legislation has been in effect since 12 November 2016 and thus any small business loans entered into or renewed from this date are protected from unfair contract terms.

ASIC and ASBFEO recently reviewed small business loan contracts from Australia's big four banks to ensure that sufficient steps were taken to comply with obligations under unfair contract terms legislation and found several areas of concern.

The survey results showed all lenders were aware of the legislation and were taking steps to comply. ASIC is expected to publish guidance on the removal of unfair contract terms in early 2018 which will assist fintech lenders to understand their obligations under the legislation. The fintech lending industry will work with ASIC and the ASBFEO to review contracts to ensure the new legislation has been applied across the fintech lending industry.

Glossary of common lending terms

This report has found that many industry participants would support initiatives to improve transparency. Some of the feedback from respondents to the survey showed that certain fees can be referred to by different names by different fintech lenders. This can be confusing to an SME trying to compare the cost of fees across products. The initial glossary of terms commenced by FinTech Australia has been expanded and is provided with the survey in the appendices to this report.

The fintech lending industry is considering the feasibility of requiring lenders to agree to only charge fees that are included in the Glossary. The intention is to undertake regular reviews of the Glossary of Common Lending Terms to capture any new fee structures deemed necessary by the industry.

Dispute resolution services

ASIC does not require fintechs that lend to SMEs to meet External Dispute Resolution (EDR) and Internal Dispute Resolution (IDR) requirements (unless their other activities require them to do so, for example if they hold a Credit license). However, fintech business lenders recognise disputes have a high impact on a fintech business and SME borrower, costing time and money to resolve. SMEs also need pathways for dispute resolution that provide quick solutions and that come at little or no cost.

As most disputes are handled quickly where the lender has effective and robust IDR procedures, a requirement to have IDR in place will form part of the Code of Conduct.

Development and disclosure of standard comparison tools

In conjunction with developing a glossary of terms, further discussion about comparative metrics and tools needs to occur. The ability of SMEs to compare the cost and features of different finance products more easily would assist them to identify what product is best for them.

The use and effectiveness of APRs as comparative tool, or as part of a set of comparative metrics was raised via the survey and the subsequent roundtable. At the roundtable, participants agreed that industry would consider whether APRs were an appropriate measure, how they might be improved as a potential comparative measure, and investigate what other options may be available. The aim of this would be to implement a standardised approach for comparing unsecured fintech business loan products by June 2018.

Simple loan contract summaries

Some fintechs already include a covering page with their loan agreements that highlights and summarises key information a SME borrower needs to understand and be aware of before signing an agreement. A further initiative to improve transparency and disclosure is the use of a simple loan contract summary page that summarises key industry-agreed rates, fees and costs. Together with the Glossary of Common Lending Terms, SMEs will be better able to understand what they are signing up to, and ensure they are clear as to the total cost, features and limitations of the product.

At the industry roundtable, fintechs agreed to resolve what information should be included as part of a standardised simple loan contract summary for unsecured small business loans ready for implement from June 2018.

Industry Code of Conduct

The initiatives described above are strong steps toward industry self-regulation. Together, they could ultimately work in support of and alongside an industry Code of Conduct or Industry Charter with sections that tailor conduct to differences in business models.

A code will not only serve to provide clear compliance guidelines for industry participants, it will provide guidelines for areas that are not currently addressed by regulations or subject to overlapping and conflicting Commonwealth and state regulations.

The code will be developed in line with ASIC's outline for the establishment of Codes of Conduct being:

- freestanding and written in plain language
- body of rules
- consultative process for code development
- meets general statutory criteria for code approval

- code content addresses stakeholder issues
- effective and independent code administration
- enforceable against subscribers
- compliance is monitored and enforced
- appropriate remedies and sanctions
- codes is adequately promoted
- a mandatory three-year review of code.

Prior to the start of the research project several fintech business lenders, led by fintech online broker Valiant Finance, had already developed, agreed and signed up to an Industry Charter. It was agreed at the roundtable to commence development of a fintech Code of Conduct, starting with balance sheet lending for unsecured business loans.

In doing so, the Code of Conduct will provide greater customer assurance and most importantly, grow trust in this emerging industry so as to ensure that it will remain viable and sustainable in the long term.

6. Policy measures to support industry growth

This report has outlined how the fintech business lending industry is rapidly developing into a viable, credible and competitive alternative to traditional finance providers. It has also considered several self-regulatory initiatives the industry should evolve and adopt to improve transparency and disclosure, in order to best serve its SME customers and build a robust foundation for stable, long-term growth.

Slow business growth and sluggish investment has limited SME's access to fintech products. As theses self-regulatory measures are implemented SME's will gain confidence in fintech products and encourage greater investment. In turn, this may lead to an increase in the economic contribution and jobs growth[42] from the Australian SME sector.

Industry respondents have raised that lack of customer awareness, trust and the high cost of acquiring funds are the most significant challenges facing the industry. While it is not appropriate for policy-makers to 'pick winners' and support individual companies in a competitive market, there are precedents for effective legislative action that can be taken to help reduce these challenges for the industry as a whole.

The UK has undertaken a variety of policy measures to support the growth of the fintech business lending sector for the same reasons listed above. In 2014 the UK government established the British Business Bank (BBB) and through accredited bank and non-bank lenders including fintechs, the BBB currently provides funding support to more than 59,000 SMEs with a total stock of finance in excess of GBP3.4bn.

Another initiative has been a legislative requirement for traditional banks to ask SMEs that have been turned down for funding whether they would like their information to be shared with designated online platforms that can match their funding needs with alternative finance providers[43].

In the USA, the Small Business Administration (SBA), which was established in 1953, has delivered millions of loans, loan guarantees, contracts, counselling sessions and other forms of assistance to small businesses. Like the BBB, the SBA works with accredited lenders including fintechs to deliver its programs and like the BBB, it generates a surplus for the taxpayer.

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[42] "In the presence of financing frictions… even small improvements in cash collection can have large direct effects on hiring due to the multiplier effect of working capital". Harvard Business School, 2016, *Can Paying Firms Quicker Affect Aggregate Employment*, Working Paper 17-004.

[43] https://british-business-bank.co.uk/finance-referral-platforms-policy/

Appendix A: Glossary of Common Lending Terms

Products and application process

Fixed term unsecured loan

An amount of credit that is disbursed to a borrower (or another nominated recipient) in full at establishment, repaid over a fixed term with an agreed number of equal payments comprising principal and interest.

As the loan is unsecured, the lender is not able to exercise an interest in any collateral in the event the borrower fails to make agreed payments.

Secured business loan

An amount of credit that is disbursed to a borrower (or another nominated recipient) in full at establishment, repaid over a fixed term with an agreed number of equal payments comprising principal and interest.

As the loan is secured, the lender may exercise an interest in agreed collateral in the event the borrower fails to make agreed payments.

For business loans, security collateral is typically an asset being purchased with borrowed funds, other business assets, or residential or commercial property owned by a director of the borrowing company.

If security collateral comprises residential or commercial property, a lender may protect their interest in that property by way of a secured mortgage (including second mortgage), or with a caveat against the title of the property that prevents selling or mortgaging that property without the lender's consent.

Line of credit / revolving line of credit

An ongoing credit facility characterised by:

- A pre-approved credit limit, being the maximum amount of credit that may be accessed by a borrower, set at establishment by the lender with reference to the borrower's objectives and borrowing capacity; and
- A balance, being the amount of credit outstanding at a point in time. Amounts of credit may be accessed by the borrower without further approval, so long as the resulting balance is below the credit limit.

Interest is charged on the outstanding balance of the facility, and periodic minimum repayments of principal are required to be made by the borrower. A facility fee may be charged to the borrower at establishment or periodically according to an agreed schedule.

Invoice finance / debtor finance / factoring

An advance of cash from a lender to a borrower, with the right to collect on unpaid invoices provided to the lender as collateral by the borrower.

The amount advanced by the lender to the borrower may differ by lender and product. For example, the face value of the invoices may be discounted or 'factored'; the value of the invoices less this discount is then paid to the borrower. Depending on the invoice finance arrangement, the amount discounted may be paid to the borrower later – typically less a fee – after the lender has collected on a portion of the borrower's invoices.

Similarly, the amount repaid by the borrower to the lender may differ by lender and product. Borrowers may be required to repay an amount exceeding the amount originally borrowed, calculated using either an interest or factor rate.

Equipment (operating) lease / finance lease

A lease is a contract in which the finance provider (lessor) is the legal owner of the leased asset for the duration of the contract. The customer (lessee) is given operating control over the asset in exchange for regular lease payments.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership from the lessor to the lessee. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

The arrangement of a finance or equipment lease is characterised by:

- The lessee selecting an asset to lease
- The lessor purchasing the asset to be leased
- The lessee being given rights to use the asset for the duration of the contract, and in return making regular payments to the lessor as described by the lease agreement

Depending on the lease arrangement, the lessee may or may not be given the option to acquire the asset during or at the completion of the lease agreement.

Vendor / program finance

An advance of credit by a vendor (or alternatively by a third party lender) to a customer for the purpose of purchasing the goods, services or real estate being sold by the vendor.

The vendor typically offers terms to the purchaser to pay a proportion of the purchase price upfront (a deposit) and the outstanding balance via regular instalments. The provision of vendor finance may or may not attract interest charges on the outstanding balance or fees in relation to the agreement.

Interest only loan

An unsecured or secured loan that is disbursed in full to a borrower (or another nominated recipient) at establishment, with no repayment of principal due until the end of an agreed term.

Periodic payments of interest amounts, typically based on the amount of credit outstanding, are made by the borrower to the lender (or capitalised to the loan balance) throughout the term of the loan according to an agreed schedule.

Overdraft
An amount of credit provided by a bank that covers a borrower's transactions when the balance of their bank account reaches zero.

Availability period
The period of time in which the loan offer is available for acceptance by the potential borrower.

Guarantor
A third party who promises to provide payment on a loan in lieu of the borrower in the event of default.

Pricing conventions

Annual Percentage Rate (APR)
The interest rate applied to a loan, expressed as an annualised rate.

Note that this definition does not align with the definition of Annual Percentage Rate as defined by the National Credit Code (NCC), which is typically designed to cover loans for Consumer use, such as Credit Cards and Mortgages.

Simple interest rate
In a given period, the amount of interest paid on a loan divided by the average outstanding loan balance in that period, annualised.

Equivalently, the annualised internal rate of return (IRR) of the cash flows received and paid.
Flat interest rate
The amount of interest paid on a loan divided by the original loan amount, annualised.
Derived by the formula:

([$Total Payback – Loan Amount] / Loan Amount x (12 / Term in Months))

For example, a $10,000 loan with an $11,000 payback over 6 months would have a flat rate APR of:

([$11,000 – $10,000] / $10,000 x (12 / 6)) = 20%

Effective Interest Rate (EIR) APR

The nominal rate per annum and including the cost of all contracted repayments and other fees and charges both upfront and ongoing, on an annualised basis.

Derived by the following formula (expressed as an Excel calculation):

Rate (NPER, -PMT, PV) x Frequency Factor (n)

Where:

NPER = the number of periodic repayments required under the loan agreement
PMT = the amount of each periodic payment, including interest, principal and all other fees
PV = the original loan amount
Frequency Factor = varies depending on repayment frequency (see table below):

Repayment Frequency	Frequency Factor
Daily	365.2422
Weekly	52.1775
Fortnightly	26.0887
Monthly	12

To see an example of the above formula in use, please use the below link which will take you to a Google Sheets sample worksheet:

https://docs.google.com/spreadsheets/d/1aODDwCdV0SMvCt5XBVVhK1IMgs_2W4tO9XksYT_6Pbc/edit#gid=1458903181 (visual is also included below)

Amount Received By Borrower($)		**10,000.00**	*being the amount received by the borrower net of day one fees and charges*
	Loan Amount (+)	10,000.00	
	Establishment Fee (-)	-	
	Other Fees (-)	-	
Number of Repayments (#)		**13**	
Frequency of Repayment		**Fortnightly**	
Amount of Repayment ($)		**824.15**	*being the total amount of each scheduled periodic payment paid by the borrower*
	Repayment (-)	824.15	
	Direct Debit Fees (-)	-	
	Other Fees (-)		
Number of Repayments (Annualised)		26.07	*being derived from the table below*
APR		**26.07%**	
Total Payback		**10,713.95**	

Frequency	**Repayments (Annualised)**
Daily	365.25
Weekly	52.18
Fortnightly	26.07
Monthly	12.00
Quarterly	4.00
Semi-Annually	2.00
Annually	1.00

Factor rate
The multiple applied to the original loan amount that arrives at the total payback on the loan (principal plus interest).

For example, a $10,000 loan with a $12,000 payback has a factor rate of 1.20x.
Discount rate
The percentage discount applied to the face value of an invoice.

Term of product, conditions and fees

Term
The contracted length of time over which a loan is due to be repaid.

Loan principal
Amount the borrower initially seeks to borrow from a lender (i.e. excluding any interest, origination and/or establishment and/or settlement fees). It is also the percentage of the periodic repayment amount that reduces the amount owed.

Total repayment / Total payback
The contracted amount due to be repaid inclusive of principal, interest and fees.

Interest payment / Total interest
The total amount of interest to be paid on the loan.

Repayment frequency
The regularity with which a scheduled repayment must be made – typically daily, weekly, fortnightly, monthly, quarterly or maturity.

Repayment amount
The contracted amount (if any) due to be repaid per period (set by the repayment frequency) for the term of the loan.

Loan amount
Amount borrowed inclusive of any origination and/or establishment and/or settlement fees.

Disbursement amount
The amount borrowed exclusive of any origination and/or establishment and/or settlement fees.

Early repayment (or prepayment)
A payment made by the borrower to the lender at an earlier time than they are required by the loan contract. Such amounts are therefore in excess of amounts contractually due by that time under the loan agreement.

Early repayment (or prepayment) fees
An amount charged in relation to an Early Repayment (or Prepayment) including interest and fees applied in excess of the contractual rate for the period ending when the Early Repayment (or Prepayment) is made.

For completeness, where the amount is indeterminate on the date the loan agreement is entered into (i.e. where the date of Early Repayment (or Prepayment) determines the Early Repayment (or Prepayment Fee), then a minimum and maximum fee should be provided.

Late payment
Where a contractual payment is received after the date on which it is due under the loan agreement.

Late payment fee
The fees applied to a Late Payment.

Dishonour / Returned payment
Where a scheduled payment, pursuant to the loan agreement, is not paid by the borrower and with no notice given to the lender.

Dishonour fee / Returned payment fee
The fees applied to a Dishonour or Returned Payment.

Payment rescheduling fee
An amount paid by a borrower to a lender for rescheduling a previously agreed payment on a given date. This is the fee associated with adjusting a repayment table after consultation between the lender and the borrower, in the event a borrower cannot make the repayments by the originally agreed due dates.

Application fee
The fee incurred to cover the cost to assess an application for a loan, calculated as the amount by which the disbursed amount of a loan is less than the notional amount of the loan.

Origination / Establishment fee
The fee incurred to cover the cost of setting up the loan when the loan is established, including producing necessary documents, repayment schedules and setting up direct debits. It is calculated as the amount by which the disbursed amount of a loan is less than the notional amount of the loan.

Settlement fee
Any fees charged by a lender to disburse funds, that is not an Application Fee, an Origination Fee or an Establishment Fee.

Drawdown fee
The fee incurred for each drawdown, calculated as the amount by which the disbursed amount of a drawing is less than the amount of the drawing under the loan agreement.

Partner / Broker commission / fee

An amount paid to a broker or referrer in relation to a specific finance agreement, where that finance agreement was entered into by a lender following a referral made or application submitted by the broker or referrer.

This amount is paid by the borrower (typically by capitalising the amount of the fee to the amount of credit) and/or by the lender.

Direct debit fee

An amount paid to a lender by a borrower for each payment made by direct debit.

Facility fee

An amount paid to a lender by a borrower for the continued provision of a line of credit to that borrower. The fee may be paid either at establishment of the line of credit, or periodically after establishment according to an agreed schedule.

Industry-specific

Stacking

Provision of a credit product to a customer who already has an outstanding loan (or loans) with one or more other lenders.

Decline rate

The percentage of full credit applications that are declined for a specific product by a lender for a specific product. (The opposite of Decline rate is the Approval rate, i.e. the percentage of full credit applications that are approved for a specific product by a lender for a specific product).

If you are interested in adding a new term and definition to this glossary, please contact FinTech Australia at hello@fintechaustralia.org.au. Additions of definitions will be considered first by the FinTech Australia team in consultation with the Lending Working Group co-leads, and then approved by the working group prior to the release of a version update.

Appendix B: Survey questions

Q1 What is your business name/trading name?

Q2 Do you want your survey responses to remain confidential?

Q3 What products do you offer? Select as many as apply.

Q4 What is your sweet spot based on term?

Q5 What is your sweet spot based on amount?

Q6 What industries will you not lend to?

Q7 How are Funds typically used by SMEs that you lend to?

Q8 How is your customer experience different to a bank issued loan product?

Q9 Why do you think your customers choose to do business with you?

Q10 How do you measure and publicise customer satisfaction?

Q11 What is your current Net Promoter Score (NPS)?

Q12 What steps do you take to ensure borrowers can readily work out exactly how much a loan is going to cost over the life of the loan?

Q13 Do you charge direct debit fees?

Q14 Can borrowers choose the repayment frequency to reduce the impost of these fees and to better suit their cash flow?

Q15 In your opinion, is the Fintech lending sector's overall level of fee transparency and disclosure...

Q16 Would you or do you support the following initiatives?

Q17 Do you disclose to borrowers details of any fees, commissions, etc paid to introducers/brokers/partners?

Q18 If yes, please provide details, in % terms, the range of fees paid to brokers/introducers (e.g. a range could be 1% to 12%).

Q19 If no, why not?

Q20 Do you have a Loan Calculator on your website?

Q21 If Yes, what fees are included in your calculation of the rates and repayments? Select as many as apply.

Q22 Do you quote an interest rate in your loan calculator?

Q23 How do you charge direct debit dishonour fees?

Q24 How do you charge loan extension fees?

Q25 How do you charge late payment interest?

Q26 Do you charge any other fees when a borrower misses a payment?

Q27 How do you charge early termination/repayment fees?

Q28 How do you charge exit/discharge fees?

Q29 Do you charge any other fees when a borrower repays early?

Q30 Do you adjust interest charges in the case of prepayments so that the total amount payable by the borrower is only based on the number of days that principal is outstanding?

Q31 Is it clear how a borrower can terminate their loan agreement and what fees and charges will accrue, including any penalties or fixed interest charges?

Q32 What do your general responsible lending practices or principles include?

Q33 What do you consider when assessing an SMEs ability to service a lending product?

Q34 How do you verify the above information?

Q35 Would you lend to a business that one of your competitors has already lent or extended credit to?

Q36 Do you think loan stacking is an issue that industry

participants and regulators should pay closer attention to?

Q37 Are you aware that Australian Consumer Law has recently been extended to protect small businesses from unfair terms in standard form contracts, which includes loan contracts?

Q38 If yes, did you make changes to your standard form contracts to comply with the legislation?

Q39 Please provide key examples of the terms that you changed or removed.

Q40 Do you have the right to change any terms when a borrower is meeting all financial commitments?

Q41 If yes, what terms can you change?

Q42 How many calendar days' notice do you provide the borrower if you change a term, before it takes effect?

Q43 How many calendar days' notice do you provide a borrower to rectify a breach of a term, before you take enforcement action?

Q44 How many pages is your standard loan contract for your key SME lending product, including all additional documents (such as general terms and conditions) that make up the overall contract?

Q45 Does your loan documentation include non-monetary default clauses such as Material Adverse Changes?

Q46 Are you a member of an External Dispute Resolution service?

Q47 Would you sign up to an industry-led charter that considered improvements to transparency and standards for SME borrowers and other customers?

Q48 Other than a voluntary charter, how do you think the FinTech industry can improve transparency and standards for SME lending?

Q49 What are the greatest challenges that exist for online SME lenders?

Endnotes:

[1] KPMG et al, Harnessing Potential: The Asia Pacific Alternative Finance Benchmarking Report, March 2016, https://home.kpmg.com/au/en/home/insights/2016/03/harnessing-potential-asia-pacific-alternative-finance-benchmarking-report.html as cited in ASIC, FinTech: ASIC's Approach and Regulatory Issues, July 2016, http://download.asic.gov.au/media/3962105/melbourne-money-and-finance-conference-2016-FinTech.pdf

[2] ASIC, The future of fintech and regulation, A speech by Greg Medcraft, Chairman, Australian Securities and Investments Commission, http://download.asic.gov.au/media/4218758/greg-medcraft-speech-british-australian-fintech-forum-published-21-april-2017.pdf

[3] Ibid.

[4] ABS definition of SMEs, 0–199 employees. ABS, Counts of Australian Businesses, including Entries and Exits, Jun 2012 to Jun 2016, cat. No. 8165.0, http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0

[5] ABS, Australian Industry, 2015–16, cat. No. 8155.0, http://www.abs.gov.au/ausstats/abs@.nsf/mf/8155.0

[6] ABS, Selected Characteristics of Australian Business, 2014–15, cat. No. 8167.0, http://www.abs.gov.au/ausstats/abs@.nsf/mf/8167.0

[7] The survey is based on businesses with less than 20 employees. CPA Australia, The CPA Australia Asia-Pacific Small Business Survey 2016 – Market Summary: Australia, https://www.cpaaustralia.com.au/~/media/corporate/allfiles/document/professional-resources/business-management/small-business-survey/small-business-survey-2016-market-summary-australia.pdf?la=en

[8] The Treasury, Backing Australian FinTech, Economic benefits of FinTech, http://fintech.treasury.gov.au/economic-benefits-of-fintech/