

**28 February 2022**

Australian Banking Association  
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By email: [submissions@bankingcodereview.com.au](mailto:submissions@bankingcodereview.com.au)

Dear Sir/ Madam

### **Banking Code of Practice – Business groups**

1. The Financial Services Committee of the Business Law Section of the Law Council of Australia (**Committee**) thanks the Australian Banking Association (**ABA**) for the opportunity to provide a submission in response to the consultation paper titled 'Business groups and the Banking Code' prepared on behalf of the ABA (**Consultation Paper**) regarding the definition of 'small business' in the Banking Code of Practice (**Code**).
2. By way of background, the Committee monitors developments in the laws and regulations governing financial services (which relevantly include the Code), actively contributing to public consultation on changes to these laws. The Committee's membership consists of legal practitioners from private practice, corporates, financial institutions and banks. The Committee regularly hosts observers from key regulators.

#### ***Key points***

3. The Committee is broadly supportive of the changes to the definition of 'small business' suggested in the report of the independent review of the definition of 'small business' conducted by Pottinger (**Pottinger Review**) and set out in the Consultation Paper.
4. In particular, the Committee agrees with the suggestion that all entities under common control as a single group should be considered on an aggregate basis when determining whether the entity is a 'small business' under the Code.
5. The Committee also generally agrees with the preliminary conclusion put forward in the Consultation Paper that a 'bright line' approach based on 'deemed control' is preferable to an approach based on practical control. Detailed submissions are provided below.

## **Submissions**

### **Preferred definition of small business**

6. The Committee generally supports the recommendations made in the Pottinger Review and, in the Committee's opinion, a deemed control test (explained in more detail below) is the preferable mechanism for applying the tests in the definition of 'small business' on an aggregate basis to business groups. A deemed control test provides improved certainty, transparency and clarity when compared to a practical control test and the Committee prefers this outcome because the Code must be understood by small business owners and efficiently applied by signatories to the Code.
7. To ensure the Code is easy to understand and apply, the Committee suggests that the definition of 'small business' should be drafted in plain English using a 'streamed' approach. Although this causes the definition to be longer, it provides an opportunity to apply different thresholds for standalone businesses and businesses that are part of a business group. This could function to address some of the submissions to the Pottinger Review which commented that agricultural businesses would be artificially excluded from the definition of 'small business' because they often have mutual directors and high aggregate business group credit but are independently controlled and would be commonly understood as small businesses.
8. The Committee suggests that the following approach to drafting should be considered:

#### **“What is a ‘small business’?”**

##### *Standalone businesses*

If a business is not controlled by another entity and does not control any entities then the business is a standalone business and is analysed as a distinct entity for the purpose of determining whether it is a small business. A standalone business is a small business if all of the following apply:

- a) the business had an annual turnover of less than \$10 million in the previous financial year; and
- b) the business has fewer than 100 full-time equivalent employees; and
- c) the business has less than \$5 million total debt (excluding debt to which the National Credit Code (**NCC**) applies) to all credit providers. The total debt includes any undrawn amounts under existing loans and any loan being applied for.

##### *Businesses that are part of a business group*

A business that is controlled by another entity or that controls another entity is part of a business group. A business group is considered on an aggregate basis for the purpose of determining whether an entity in the business group is a small business.

An entity 'controls' another entity if any of the following apply:

- a) it is a director or trustee of the entity;
- b) it is a partner or joint venturer in the entity, and there are no more than four partners or joint venturers in that entity; and
- c) it has an interest in the entity of 25% or greater ('interest' includes a shareholding, unit holding, partnership or joint-venture interest).

If the business is part of a business group, the following entities are in the business group and are assessed together:

- a) the business;
- b) entities controlled by the business;
- c) entities controlling the business; and
- d) entities controlled by an entity controlling the business.

Businesses that are part of a business group are only 'small businesses' if:

- a) the total annual turnover of the business group was less than \$10 million in the previous financial year; and
- b) the business group has fewer than 100 full-time equivalent employees in total; and
- c) the business group has less than \$10 million total debt (excluding debt to which the NCC applies) to all credit providers. The total debt includes any undrawn amounts under existing loans and any loan being applied for.

*Businesses that are never 'small businesses'*

A business is not a 'small business' if it is:

- a) a member of a business group which includes a member that is listed on the Australian Securities Exchange;
- b) a government entity;
- c) a partnership or joint venture with more than four partners or venturers; or
- d) the holder of an Australian financial services licence (**AFSL**) that is authorised under its AFSL to operate registered managed investment schemes as a responsible entity or to provide custodial and depository services."

## Comments on the Consultation Paper

### *Annual turnover to remain at \$10 million*

9. The Committee agrees that the annual turnover threshold should remain at \$10 million. This is consistent with the aggregated turnover threshold used in the definition of 'small business entity' in section 995-1 of the *Income Tax Assessment Act 1997* (Cth).
10. In the Committee's opinion, an annual turnover test is preferable to other financial tests, such as the upfront price payable test which appears in section 12BF(4)(b) of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**). This is because the Code is intended to protect small business customers on the basis that they have unequal bargaining power in dealings with Code signatories. If an upfront price payable threshold is applied, sophisticated entities might acquire products priced below the threshold and be protected by the Code where such protection is unwarranted given their bargaining power.

### *Employee limit to remain at 100*

11. The Committee agrees that the employee threshold should remain at 100 full time equivalent employees.
12. The 100 employee threshold is consistent with the Australian Financial Complaints Authority (**AFCA**) definition of 'small business'. The Committee notes that, for the definition of 'small business' in section 12BC(2) of the ASIC Act, the employee threshold is 100 people if the business includes the manufacture of goods or otherwise is 20 people. A similar two-stream test was included in the definition of 'small business' in the 2003 version of the Code but this was amended to a single 100-employee threshold in the 2019 version of the Code. In the Committee's opinion, the simplicity offered by a single-strand test is preferable to industry-specific thresholds.
13. A 20-employee threshold applies for the purposes of the unfair contract terms regime. The definition of 'small business contract' in section 12BF(4)(a) of the ASIC Act has a single employee threshold of 20 people. This is reflected in section 23(4) of the Australian Consumer Law in Schedule 2 of the *Competition and Consumer Act 2010* (Cth). The 20 person threshold was adopted for the unfair contract terms regime because it was a 'commonly used head count measure and has been found by the Australian Bureau of Statistics to provide a good proxy for a small business'. However, in the Committee's opinion this lower threshold would inappropriately exclude a number of small businesses that the Code is intended to protect.
14. The Committee acknowledges the Pottinger Review's observation that the number of different definitions of 'small business' for different purposes creates confusion. However, in the Committee's opinion, it is effective to retain a threshold of 100 employees for the purpose of the Code, despite the 20 employee threshold used in the unfair terms regime. This is consistent with submissions from stakeholders that the Code should support more small businesses rather than fewer.

*Increasing the credit limit from \$3 million to \$5 million*

15. The Committee generally supports the proposal to increase the credit limit from \$3 million to \$5 million as was recommended in the Royal Commission and the Pottinger Review.
16. A \$5 million threshold would be consistent with the small business credit limit in AFCA's Rules and would therefore promote consistency.
17. However, given the Committee's recommendation that a deemed control test should be adopted in order to aggregate the credit of a business group, the Committee recommends applying a higher aggregate credit threshold of \$10 million for business groups to include a number of agricultural businesses that fall into the definition of a 'business group', and have high aggregate credit but would usually be considered small businesses. This is explained in detail below in paragraphs 36 to 39.

*Stating that debt to which the NCC applies is excluded*

18. The Committee generally supports ensuring that the definition of 'small business' can be understood without needing to cross-refer to other definitions in the Code.
19. Although expressly excluding debt to which the NCC applies is arguably redundant (because services where the NCC applies are excluded from the definition of 'business'), the Committee's view is that this does not convolute the definition; rather, it clarifies it.

*How many partners or joint venturers should be above the threshold of "small business"?*

20. It is difficult to recommend the exclusion of a partnership or joint venture from the definition of 'small business' simply because it had a particular number of partners or joint venturers.
21. The Committee's view is that it would be better to allow the tests of turnover, amount of credit and number of employees to do the work of classifying whether the partnership or joint venture takes the benefit of the Code.

*Applying all three tests in the aggregate for a business group*

22. The Committee generally supports the proposal to apply all three threshold tests in the aggregate for a business group.
23. The Committee considered the effects of applying an approach of treating an entity as a small business if it satisfied 2 of the 3 tests and found that it had some unwanted consequences; for example, potentially including larger organisations when borrowing smaller amounts.

*How many partners or joint venturers would cause an entity to not be controlled by a single partner or joint venturer?*

24. The Committee recommends that a partnership or joint venture with more than four partners or joint venturers should be considered not to be controlled by a single partner or joint venturer.

25. This is reflective of the definition of 'owns' in relation to a 'beneficial owner' in rule 1.2.1 of the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007* (No. 1) (Cth), where a 25% interest constitutes beneficial ownership of the relevant entity.

*What should the minimum threshold be for an interest to constitute control?*

26. The Committee recommends that a holder of a 25% interest in an entity should be taken to control the entity, to maintain consistency with comments made in paragraphs 24 and 25 above.
27. A threshold of 50% or more direct voting interest or 15% or more direct control interest is used for the control test in section 1207Q of the *Social Security Act 1991* (Cth), which is used for the purposes of section 11 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth).
28. The Committee prefers an ownership based test because the Committee believes that it provides a 'bright line' approximation of control that is easy for a small business owner to understand, rather than importing other considerations into the definition.

### **Comments on the definitions of 'business group' in the Consultation Paper**

*Option 1: Based on practical control*

#### **Importing the definition of "control" from the *Corporations Act 2001* (Cth) (*Corporations Act*)**

29. Although a definition based on the existing Corporations Act section 50AA test would be based on well-established legal principles, the consumer-facing nature of the Code necessitates that the definition of 'small business' is understood by small business owners who may not be familiar with the Corporations Act definition. In the Committee's view, it is strongly desirable that the Code is self-contained and the definition of 'small business' should be understood without the need to refer to legislation or to other standards (such as the accounting standards).
30. The Committee agrees that, although importing a plain English version of the Corporations Act definition would eliminate the need for a small business to refer to or be familiar with the Corporations Act, this would undermine the advantage that the principles of the proposed test as written are themselves already well-known.
31. Even if a new plain English test were created on the basis of the Corporations Act definition, the factual interpretation required to apply a practical control test would be unnecessarily complicated, whereas a 'bright line' test would effectively capture the recommendations made in the Pottinger Review.
32. Although a practical control test may better account for certain use cases, such as an agricultural business operating independently but owned by members of the same extended family (as identified in the Pottinger Review), in the Committee's opinion this use case could also be accounted for by adjusting the test thresholds for business groups. This is discussed below in paragraphs 43 to 44.

### 'Reasonably considers'

33. The Committee generally does not support allowing Code signatories to apply a discretionary interpretation of the 'small business' test. The Committee is concerned that this would make it difficult for a small business to understand whether the Code applies to it and would place a discretionary power in the hands of Code signatories, which is counter to the purpose of the Code as a mechanism for equalising bargaining power.
34. The Committee has similar concerns about allowing Code signatories to rely on a customer's self-declaration about control, as it may permit signatories to encourage small businesses to contract out of the Code.
35. These issues would be better remedied by applying a deemed control test rather than a practical control test.

### *Option 2: Based on deemed control*

36. For the reasons outlined in this letter, the Committee prefers a definition of 'business group' that is based on "deemed control" as described in the Consultation Paper. By deemed control the Committee therefore means a definition that is founded on specific conditions which are taken to be control if the conditions are satisfied.
37. A deemed control test allows the Code to be read as a standalone document rather than with reference to legislation. It also allows entities to understand and interpret the Code more uniformly as the need for discretionary application is minimised.
38. The Committee acknowledges that the director limb of the deemed control test poses challenges. For example, entities with a common director will be aggregated even if there is no practical relationship between them, and individual directors' business borrowings outside the entity will be included in the aggregation. This is a particular concern in the agricultural sector, described below in paragraphs 43 to 44.
39. In the Committee's opinion, the likelihood that more agricultural businesses would fall into a business group could be managed by applying a slightly higher aggregate credit threshold for business groups. This may accommodate for situations where family-owned agricultural businesses have more credit but are not practically related, whilst the aggregate turnover and employee thresholds would still ensure sophisticated entities fall outside the definition of 'small business'.

### **Test cases**

#### *Businesses that are part of large, sophisticated groups*

40. The Pottinger Review noted that an effective definition of 'small business' should exclude a business that is part of large, sophisticated group because the Code is not intended to provide protections for that kind of business and its ability to access relevant institutional banking products may be inhibited by being classed as a small business.
41. The previous definition of 'small business' did not consider partnership and joint venture structures on an aggregate basis.

42. Any of option 1, option 2 or the Committee's recommended definition would remedy this problem.

*Small agricultural business operating independently but owned by members of the same extended family*

43. The Pottinger Review also noted that the current definition of 'small business' inappropriately excludes some businesses from the protections offered to small businesses under the Code, such as small agricultural business operating independently but owned by members of the same extended family. In particular, 'family-owned farms and other businesses in the agricultural sector with greater than A\$5m in credit are not necessarily large or sophisticated borrowers'.
44. In the Committee's opinion, this issue would be best resolved by refining the aggregate borrowing limit for business groups rather than importing a practical control test.

**General comments**

*Audience of the Code*

45. There is a strong case for ensuring that the language used would be accessible to people who run small businesses, who may not be tertiary educated.

*The Code should be clear and transparent*

46. The Committee agrees with the suggestion in the Pottinger Review that the precision of some of the terminology used should be improved so that there is greater clarity and consistency regarding which enterprises are treated as small businesses. The Code should give small businesses confidence and transparency as to whether or not they are (and will continue to be) treated as a small businesses by any particular bank.

*The Code, and the definitions in the Code, should be self-contained*

47. In the Committee's view, it is strongly desirable that the Code is self-contained and therefore the definition of 'small business' should be understood without the need to refer to legislation. Similarly, cross-referring between definitions in the Code should be minimised.

*The Code should promote consistency and be fit for purpose*

48. The Committee generally agrees with the suggestions in the Pottinger Review that the Code should contribute to reducing the number of different definitions of small business that are used in Australia.
49. However, as the Pottinger Review acknowledges, many of the definitions employed in other areas are tailored to the nature of focus of each body administering the relevant test.<sup>1</sup>
50. For that reason, given the variety of different tests in other regimes, at this stage the Committee recommends tailoring the definition of 'small business' in the Code to best fit its purpose rather than aiming only to provide consistency.

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<sup>1</sup> Pottinger Review page 58.

## Contact

51. Please contact the Chair of the Financial Services Committee, Pip Bell, at [pbell@pmclegal-australia.com](mailto:pbell@pmclegal-australia.com), if you would like to discuss any aspect of this submission.

Yours faithfully

A handwritten signature in black ink, appearing to read 'P. Argy', with a long, sweeping flourish extending to the right.

**Philip Argy**  
**Chairman, Business Law Section**