Borrowing from fintech lenders

Australian Government

Australian Small Business and Family Enterprise Ombudsman

the BankDoctor

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This publication is a joint project between the Australian Small Business and Family Enterprise Ombudsman and theBankDoctor.org.

theBankDoctor.org is a not-for-profit online resource centre developed by Neil Slonim, a recognised independent small business finance expert. theBankDoctor.org aims to help SMEs improve their awareness and understanding of the range of business financing options including fintech lenders. Neil was primarily responsible for bringing together ASBFEO and Fintech Australia to conduct a survey – Fintech lending to small and medium-sized enterprises (SMEs) – which led to the February 2018 report Fintech Lending to SMEs – Improving Transparency and Disclosure. This report highlighted a number of steps stakeholders would undertake, including the production of this education piece written for small business owners, who might be considering borrowing from a fintech lender.

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What is a fintech lender?

Fintech lenders use online technology to provide finance to businesses and individuals. They offer short-term loans with a quick turnaround from application through to approval and money in your account.

Fintech lenders charge higher interest rates than banks as they take more risk – they don't require property as security, such as a mortgage over your home. Loans are generally unsecured but a fintech lender will take a personal guarantee from the owners and / or directors of the business.

Terms are usually three months to three years, with amounts up to $1m available. Generally, loans are for less than $100,000 and for terms of one year or less. The amount you can borrow will depend on the fintech lender's assessment of your ability to repay the debt.

What do SMEs like about borrowing from a fintech lender?

Why do SMEs borrow from fintech lenders?

The most common reasons for borrowing from a fintech lender are to purchase equipment, manage cash flow, purchase inventory and to expand a business.

What products do they offer?

The most common types of loans offered by fintech lenders are:

Product	Description
Fixed term unsecured loan	An amount of credit provided to a borrower, in full, at establishment. The amount is repaid over a fixed term by an agreed number of equal repayments made up of principal and interest. Unsecured means the fintech lender will not take security over the assets of the business. The fintech lender can seek to wind up the business as an unsecured creditor if you fail to make repayments.
Secured business loan	An amount of credit provided to a borrower, in full, at establishment. The credit amount to be repaid over a fixed term by an agreed number of equal repayments made up of principal and interest. The fintech lender will take an interest over assets as security and can take control of these assets in the event you fail to make repayments.
Line of credit	An ongoing credit facility with a pre-approved credit limit, much like an overdraft. Amounts of credit may be accessed by the borrower without further approval up to the approved limit. Interest is only paid on the amount drawn down and periodic repayments of principal are required.
Invoice / debtor finance	An advance of cash from a lender with the right to collect on unpaid invoices. The lender advances you the value of unpaid invoices less a discount (factor rate). The lender may or may not be noted on your customer invoices.

What's in a loan?

- Principal – the amount you borrow
- Interest – calculated and expressed as a percentage of the amount borrowed
- Term – the length of your loan
- Repayment frequency – how often you need to make repayments
- Fees – amounts charged by the lender to open and manage your loan

Make sure your repayment schedule is inclusive of principal, interest and all fees.

What fees will be charged?

You will incur a fee to open the facility. Other fees will apply and vary between fintech lenders. They may include:

- Origination/application/establishment fee – generally drawn out of the loan on day one
- Loan guarantee fee – added to each payment
- Loan servicing fee – added to each payment
- Late payment fee – a dollar amount or percentage, added daily to the outstanding loan.

If you do not understand a fee, ask the lender what it means, when it will apply, and how it affects the amount you need to pay back.

What terminology is used?

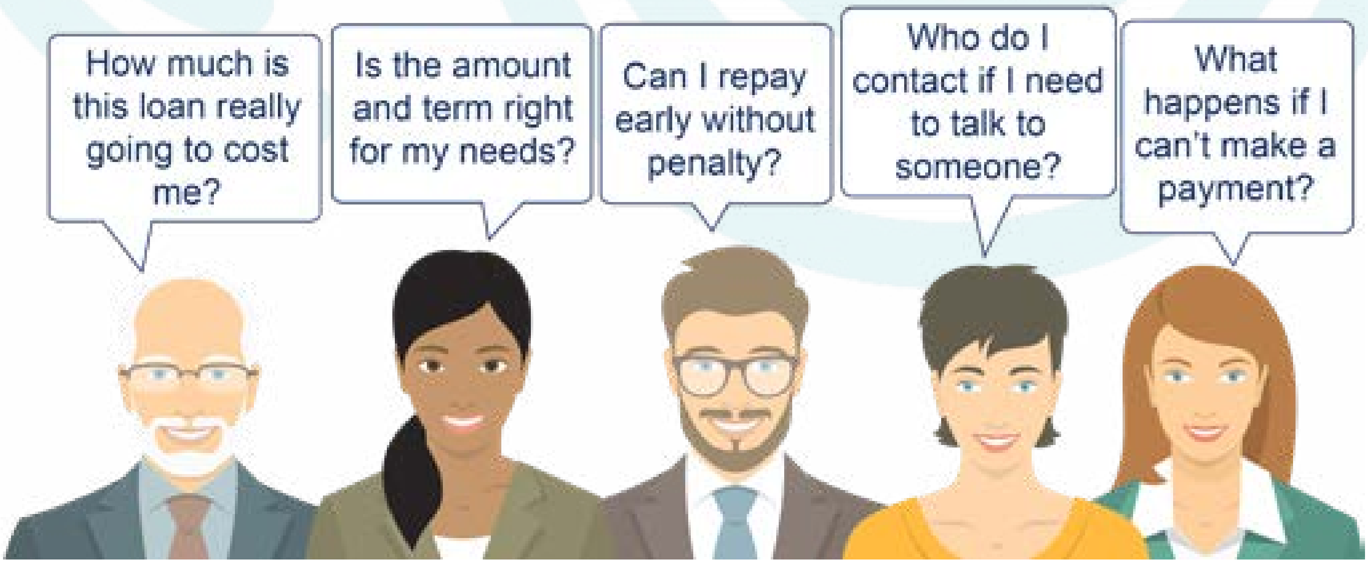
Term	Explanation
Annual percentage rate	The interest rate applied to a loan, expressed as an annualised rate.
Disbursement amount	The amount borrowed exclusive of any origination and/or establishment and/or settlement fees.
Discount rate	The percentage discount applied to the face value of an invoice.
Facility fee	An amount paid to a lender by a borrower for the continued provision of finance.
Factor rate	The multiple applied to the 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.
Repayment amount	The contracted amount due to be repaid per period for the term of the loan.
Total repayment (loan)	The contracted amount due to be repaid inclusive of principal, interest and fees.

For the full glossary, see Fintech Australia's Glossary of common terms.

How do they differ from banks?

Difference	Explanation
Application process	Most of the interaction between you and the fintech lender will be conducted online or over the phone. Fintech lenders use technology to assess your application. They will access and analyse your bank statements, accounting records and other data to reach a decision. The fintech lender may want to discuss your application to ensure they fully understand the nature of your business, the purpose of the loan and your ability to repay it.
Regulation	Fintech lenders do not have to comply with the same regulations as banks. In fact, the law provides the lowest level of protection to commercial loans, which includes loans to small business. Having a dispute resolution process is optional, so before you enter a contract it is worth checking what happens if a dispute arises.
Security	Fintech lenders do not require bricks and mortar for security but may register a General Security Agreement over company assets. They will almost always insist on taking personal guarantees from the business owners and/or company directors.
Products	Fintech lenders primarily offer only loan products compared to the wide range of products offered by banks such as transaction and deposit accounts. What they can offer is determined by the type of licence they hold.
Pricing	Fintech lenders are at a disadvantage relative to banks because they have to pay more for their money. Also, as fintech lenders do not require bricks and mortar they are taking on more risk. While you are more likely to be able to get a loan from a fintech lender without bricks and mortar, you will pay more to offset the higher cost and risk.

What should I consider before I borrow?



What information do fintech lenders seek?

Fintech lenders will need to see the financial and banking history of your business. To maximise the benefits of borrowing from fintech lenders the quickest, and preferred, method is to provide direct access to your records through a cloud-based accounting software package and banking data permissions. Bank permission allows fintech lenders to run their analytical tools to speed up the credit decisions. Data transferred between your bank and the fintech lender is encrypted.

In most cases a fintech lender will consider your application if you provide information in paper form. However, if only paper form data is provided, turnaround will be longer.

How much can I borrow?

Before approaching a fintech lender work out how much you really need. Consider what else may happen during the term of the loan. Borrow too much and you will pay unnecessary interest, fees and charges. Borrow too little and you will incur extra fees for a new loan. Also keep in mind, if you go back for a second loan it may not be approved.

The fintech lender will use a number of factors to calculate how much they will lend you. You do not need to take the full amount if this is more than you need.

Fintech lenders will consider a number of factors including:

- business turnover and profits (ability to service the debt)
- business level of debt, credit history and score
- business owner's personal credit history
- business length of trading
- industry sector.

What security will I need?

Fintech lenders will almost certainly require a personal guarantee. In addition they may register an interest over the assets of your business through the Personal Property Security Register.

What is the Personal Property Security Register?

The Personal Property Security Register (PPSR) is a national database that registers security interest in personal property. For example, to lend against an invoice, a lender will register title over the underlying goods.

For more information on how it works visit the PPSR website. The business guide booklet can get you started and the case studies are examples of how it works in practice.

Can I borrow from multiple lenders?

Borrowing from more than one lender is known as 'loan stacking'. Before taking out a loan from a second lender, check if this is allowed under your first loan agreement. Some lenders don't like it when other lenders come over the top and offer more debt, especially if the first lender does not register an interest on the PPSR and the next lender does. This could result in a demand to pay out the first loan.

How much will it cost?

The cost of borrowing means the total of the loan + interest + fees and charges. This is known as the total payback and can be found in the summary of the loan agreement.

The interest rate quoted by a lender will not include their fees and charges.

The example below is drawn from a loan agreement summary for a loan for $100,000 over six months, with an interest rate of 10 per cent and total fees and charges of $2,000.

Loan amount	$ 100,000
Interest	$ 10,000
Total payback	$ 112,000

As you can see, the total payback is more than simply the loan + interest. The interest + fees and charges of $12,000 means you will repay an additional 12% of the loan amount.

You may also be provided the Annualised Percentage Rate (APR), which shows the total cost of borrowing on an annualised basis. In the example above, the 10 per cent interest rate is for a six-month term, but 10 per cent for six months means 20 per cent for 12 months. Then, when you take into account the fact that the loan is amortised over the term, the APR works out to be 45%.

If you miss a payment, even by one day, the total payback and APR could increase dramatically through the application of penalty interest rates and additional fees.

Also, be aware that you may have to pay the total amount of the interest calculated when taking the loan even if you pay back the principal early.

How does the term impact the total cost?

Being able to accurately forecast your cash flow is critical in helping you determine what the best term is. A shorter loan term generally means you will have higher repayments, which could make your cash flow tight. On the other hand a longer term means you might be paying interest and fees for longer than you need.

What about payment frequency?

Business loans are usually paid back in equal instalments across the life of the loan. The lender will dictate the payment frequency which can be daily, weekly, fortnightly or monthly. Some lenders charge direct debit fees, which can add up, especially if you repay daily.

Are loan calculators useful?

Loan calculators can be a useful tool. They allow you to experiment with variables, such as the term of the loan, to see how they impact on the repayments and total cost. While they indicate the approximate cost, the final offer may be different when the fintech lender has completed a full assessment of your business.

Calculators vary between fintech lenders. Some will include fees, such as your origination fee and others will not. The only truly accurate way to find out and compare the real cost of a loan is to make a formal application. Be aware though that every application you make is recorded on your credit history and has a negative impact on your credit rating.

Should I use a broker?

Brokers provide a service to businesses by matching them with a suitable lender – a bank or a fintech lender. When brokers shop around lenders, it is not recorded on your credit history. Only when you make an application to a lender, is it recorded.

Using a broker can save time and effort but you need to be comfortable that the broker will act in your best interests, rather than place you with the lender that pays them the most commission.

There are many types of brokers. For business finance, look for a finance broker rather than a mortgage broker.

How do I choose a broker?

Be prepared and ask plenty of questions. Check if the broker knows your industry, which lenders are in their network, and the amount of commission and who pays it. Check they do not charge you fees on top of the commission they get from the lender.

Where do I go if I have a problem or complaint?

Firstly, check if the fintech lender has a formal dispute resolution process. From 1 November 2018, you can also take your issue to the Australia Financial Complaints Authority if your fintech lender is a signatory to the Code of Lending Practice.

If you are unable to resolve the dispute with your fintech lender you can call the ASBFEO Assistance team on 1300 650 460.

If you are unable to resolve the dispute with your broker you can lodge a complaint with ASIC through their infoline 1300 300 630.

Code of Lending Practice

On 29 June 2018, the Australian Finance Industry Association released its Code of Lending Practice for balance sheet lenders in the fintech industry. Currently, the Code only covers unsecured loans to small businesses. Compliance with the Code will be monitored by an independent Code Compliance Committee.

Signatories are required to:

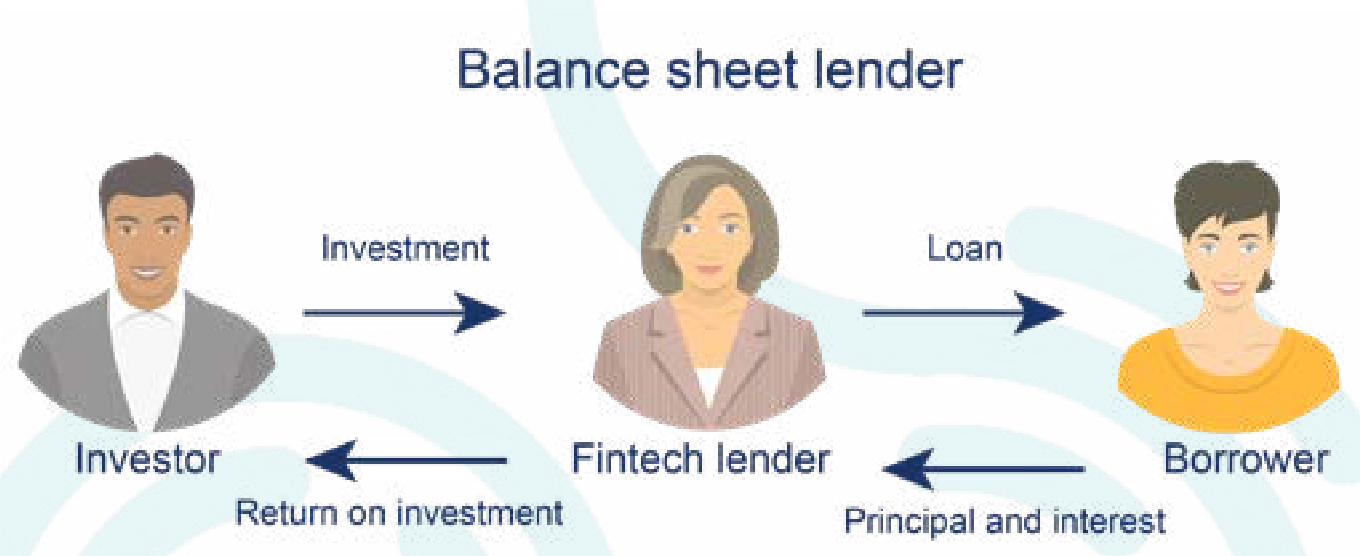
- meet a set of standards about how they will engage with borrowers
- provide borrowers with a standard pricing comparison document including the annual percentage rate (APR), the total cost of capital, and the periodic repayment amount.
- be a member of the external dispute resolution scheme, the Australian Financial Complaints Authority (AFCA).

Signatories at 29 June 2018 are Capify, Get Capital, Moula, OnDeck, Prospa and Spotcap. The signatories have committed to being compliant with the Code by 31 December 2018. The intention is for the Code to be expanded to include other products and other fintech lenders.

The different types of fintech lenders

There are two broad business models for fintech lenders – balance sheet lending and marketplace or peer-to-peer (P2P) lending. The major difference between the two is how they source and provide the funds to borrowers.

Balance sheet lenders – source money from capital markets and investors as debt and/or equity and hold it on their balance sheet as an asset. They aim to make a profit by lending at a higher rate, to cover costs and loan losses, just like a bank.



Marketplace lenders – provide a platform which matches retail and/or professional investors with borrowers. Here the investors carry the risk of losses for loans they are exposed to. Marketplace lenders make their money by charging fees to borrowers and/or investors for providing the matching service.