



16 June 2017

Senator Malcolm Roberts
Committee Chair
Select committee on Lending to Primary Production Customers
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

By Email: primaryproductionlending.sen@aph.gov.au

Malcolm

Dear Senator Roberts

RE: LENDING TO PRIMARY PRODUCTION CUSTOMERS

We support the objectives of the Committee and steps for improving outcomes for primary producers, including small businesses and family enterprises.

The Australian Small Business and Family Enterprise Ombudsman completed the Small Business Loans Inquiry in December 2016. We take this opportunity to enclose a copy of our final report for your reference as many aspects of the report are relevant to your terms of reference.

Our Inquiry reviewed a selection of cases submitted to the Parliamentary Joint Committee Inquiry into the Impairment of Customer Loans. About a third of these cases were simply poor business decisions where the bank or financial institution acted reasonably, a third a mixture of poor business decisions and poor bank/financial institution practice and a third where there are very real issues where bank/financial institution conduct was unacceptable and possibly unconscionable.

Throughout the inquiry, we consulted with a number of small business owners involved in primary production where we identified specific issues associated with lending to primary producers. There are key factors that differentiate these loans from other types of lending allowing lending practices to have a magnified impact on primary producers.

Characteristics of primary production small businesses

Prior to outlining the challenges to small business operating in the primary production industries, it is worthwhile to examine some of the general characteristics of small businesses involved in these industries. These observations are derived from businesses we examined in our inquiry, and others who subsequently approached us operating in the identified industries. Often the business is a family enterprise, centred around a central farming operation which may have secondary diversified

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operations, usually still related to primary production. Many are inter-generational businesses. Anecdotal information provided to us during the course of the inquiry indicated a typical farming operation loan would be up to \$5 million due to the cost of purchasing a property and related equipment and inputs. Loans of this size are not typically classified as “small business” loans by financial institutions using their own definitions, despite the businesses seeking the loans by other definitions (including the Australian Bureau of Statistics and the Australian Taxation Office) being exactly that: small family businesses.

Income for these businesses is largely seasonal, tied to market cycles and subject to externalities which can severely change the fortunes of the business, including weather and exchange rates. Cash flow requirements however are constant with on-going needs for inputs such as stock feed, equipment maintenance, employee salaries and benefits. The primary production operations of these small businesses tend to be industry specialised and location specific. This makes valuation of such businesses also a specialised and location specific skill. Small businesses in these industries can appear asset rich at face value, however much of the assets tend to be illiquid, with thin markets for resale or quick disposal.

Loan contract terms and lending practices

Our inquiry concluded that terms and conditions in the small business loans enabled financial institutions to legally pursue businesses for non-monetary default if certain loan covenants were breached. This could include non-monetary default due to loan-to-value ratios (LVR) dropping past the institutions commercially acceptable appetite for risk, or other financial ratios and/or generalised ‘material adverse change’ clauses. We recommended the removal of these clauses that grant banks to unilaterally invoke security asset valuation during the life of loan financial covenants and catch-all ‘material adverse change’ clauses.

Similarly, we found that notice periods prescribed in clauses and covenants included in small business loan contracts can be disregarded by banks and recommended a 30-business day notice period to all general restriction clauses and covenants (except for fraud and criminal conditions). This would give borrowers more time to respond and react to a breach of conditions, reducing the chance of a business in good financial standing being subject to a loan default. We also recommended a longer notification timeframe (in excess of 90 business days) of a decision on rolling over a small business loan, particularly for rural properties and complex businesses that would take longer to sell or refinance.

Dispute Resolution and role of third parties

Our inquiry provided input into the Review of the financial system external dispute resolution framework (the Ramsay Review) regarding external dispute resolution and we are continuing to provide input into their review under their extended terms of reference. Regarding internal dispute resolution, we recommend financial institutions implement customer advocates to supplement their internal dispute resolution processes. We also identified limitations with the existing external dispute resolution service, the Financial Ombudsman’s Service (FOS), particularly around limitation to their terms of reference for considering complaints. This centred on the loan

threshold for accessing the service and instances when the FOS would not consider a dispute that had been to Farm Debt Mediation (FDM). We also recommended a national consistent approach to FDM. Presently, each state deals with FDM in different ways. Some are legislated and others are voluntary. The schemes lack consistency and are open to interpretation, causing confusion; and there are no formal arrangements in Tasmania or the Territories. We would note that the Government has recently announced the Australian Financial Complaints Authority in response to the Ramsay Review.

Our inquiry made several recommendations around the role of valuations, receivers and investigative accountants. As we noted earlier on our submission, valuation of primary producing small business assets is a localised and industry specific. There are issues whereby small businesses pay for a valuation but do not see instructions to the valuer, or the valuation report. There is also a lack of understanding by small business owners about the temporary nature of a valuation. We also recommended greater transparency around the instructions and outputs of investigative accountants and their subsequent appointment as receivers on behalf of a secured creditor, which can give the appearance of a conflict of interest in some instances.

We trust these comments will assist you and we welcome the opportunity to discuss these matters with you further if required. Please feel free to contact either myself or Mr James Strachan, by telephone or email

Yours sincerely,

Kate Carnell AO

Australian Small Business and Family Enterprise Ombudsman

Enclosure (Inquiry into Small Business Loans)