

16 June 2017

The Committee Secretariat
Select Committee on Lending to Primary Production Customers
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Submission to the Senate Select Committee into Lending to Primary Production

Rural Bank welcomes the opportunity to provide this submission to the Senate Select Committee inquiry into Lending to Primary Production (Inquiry).

Rural Bank is a wholly-owned subsidiary of Bendigo and Adelaide Bank Limited and as the country's only Australian-owned specialist agricultural bank, we exist to support a prosperous agricultural sector and provide exceptional financial services, knowledge and leadership for farmers to grow.

In 2014, the Bendigo and Adelaide Bank Group invested further in the agricultural industry with the purchase of specialist agribusiness lender, Rural Finance, who have been supporting Victorian farmers and agribusiness for more than 70 years.

We pride ourselves on championing Australian agriculture, Australian farmers and improving the growth of the sector through the provision of customised agri-banking services and products that make a real and tangible difference to people's economic well-being.

Being a specialist agricultural bank enables us to deeply understand agricultural cycles, the specific drivers of the sector and seasonal variations. This allows us to take an informed and long term view of farm business performance.

Our specialist farm finance tools are available nationally via our proprietary business and a network of banking partners, including Elders and the Bendigo Community Bank® network. Rural Bank released its FMD Offset Account in late 2016 and it remains the first and only account of its kind in the market. It's a product that provides farmers greater flexibility in dealing with seasonal fluctuations as well as the day-to-day challenges of agriculture.

We have a history of active involvement in industry groups together with participation in reviews relating to primary industries and producers, the broader agriculture industry and rural and regional communities. In recent times, Rural Bank has worked closely with the Australian Bankers' Association (ABA) to improve industry practices and develop guidelines for:

- appointment of receivers, administrators and liquidators;
- valuation practices; and
- farm debt mediation.

Rural Bank has invested in a number of initiatives to strengthen farmer resilience including through a partnership with the National Centre for Farmer Health. Contributing to informed and evidence based decision making we invest in AgAnswers, our specialist market insights division, providing useful and timely financial information and property, industry, commodity and weather insights.

Response to the Terms of Reference

This submission provides a brief response to each of the four key areas highlighted in the terms of reference. Rural Bank can present additional commentary to the Committee should it be required.

a. The lending, and foreclosure and default practices, including constructive and non-monetary default processes;

As an agricultural specialist bank, Rural Bank has developed a suite of lending policies and procedures specifically directed to the origination and management of credit exposures to primary industry customers, delivered by regionally based sales teams and credit bureaus, located in close proximity to our primary producer customers.

New credit exposures and annual reviews of credit exposures involve information gathering from our customers, usually conducted on farm, followed by analysis of the information provided. Amongst other things this includes a review of cash flow budget projections, debt serviceability, historic profit and loss statements, balance sheets, security and security valuations.

Debt Serviceability assessment includes:

- Income projections tested against conservative year-in-year-out commodity prices and customer yields.
- Farm operating cost projections reviewed against historic performance and industry / geographic performance.
- Debt servicing tests including allowances for obligations due on all debt.
- Estimation of living allowance based on historic performance.
- Reasonable allowance for ongoing capital expenditures.
- Interest rate sensitivity.

Equity assessment forms an important part of the equation. A higher equity level provides customers with a cushion to withstand the seasonal variabilities of agricultural production and commodity price/income fluctuations, however lower equity levels may be considered acceptable where the ability to reduce debt in a shorter term is apparent.

Security is also an important credit assessment criteria, but not a primary consideration. APRA Prudential Standard APS 220 confirms this approach, noting reliance on collateral must not be a substitute for appropriate assessment of a customer's ability to meet their contractual obligations.

Mortgaged real estate properties are valued at the time of loan origination and approximately every three years thereafter, with mortgaged crops and livestock valued annually.

1. Foreclosure and Default Practices

Rural Bank has a demonstrated record of working with primary producers when they encounter financial difficulties. This includes working with their advisors and Rural Financial Counsellors through Farm Debt Mediation or other avenues to agree mutually acceptable outcomes in restructuring facilities. These approaches are supported by our Hardship Policy and Asset Management Policy and administered through a specialised team.

These specialised resources meet the APRA APS220 requirements for Authorised Deposit taking Institution's (ADI) to have reporting systems in place to identify credit exposures where the risk profile

is deteriorating together with policies and procedures to ensure timely and appropriate responses to address the credit exposure in question.

2. Default Practices

Monetary defaults are evidenced when interest and or principal payments are not met, or scheduled limit reductions to overdraft accounts are not achieved.

Non-monetary defaults may arise where an annual review, or other credit event, has identified a deterioration in the customer's financial position, debt servicing capacity or valuation of loan security. Non-monetary defaults themselves rarely lead to recovery action being initiated.

Where a default is identified, customer engagement will likely be with the specialist team and will include:

- Referral to the local Rural Financial Counsellor or other specialist advisors for support and guidance;
- A remedial proposal developed with the customer which, depending on the circumstances, may comprise strategies to improve business performance, injection of additional equity, restructure of lending facilities, variation of repayment arrangements, the sale of surplus assets with restructure of residual debt, provision of additional working capital support and/or refinance with another financial institution;
- Depending on the size of operations / complexity / financial information available, Rural Bank may invite an independent consultant to review all available financial data and provide advice on sustainability and feasibility of remediation proposals. This option is exercised in only exceptional circumstances.

Once a strategy has been agreed, it will be monitored, often over a number of years. If a strategy cannot be agreed with the customer and / or a previously agreed strategy fails to achieve remediation of the default, further action may be taken that could include Foreclosure/Enforcement to recover the debt.

3. Foreclosure / Enforcement

We understand the challenges of agriculture as a sector and the stress that ensues from deteriorating financial circumstances. As a result we provide our customers with every reasonable opportunity to preserve their livelihood and farming properties.

In our experience enforcement action arises through a combination of circumstances rather than a single event. Foreclosure is a last resort and is only entered into once all other avenues to remedy defaults have been explored and exhausted.

Procedures for foreclosure / enforcement include:

- Written confirmation to the customer of the occurrence of the default;
- An invitation to take part in Farm Debt Mediation (FDM) as applicable in relevant states;
 - In Victoria and New South Wales legislation makes it compulsory for the Bank to offer mediation before commencing debt recovery proceedings. In Queensland the Bank is a signatory to the Queensland Farm Finance Strategy that requires the Bank to offer mediation before commencing recovery proceedings. We also note the Queensland Government are presently legislating for compulsory Farm Debt Mediation. In South Australia, Western Australia and Tasmania mediation is not compulsory however the

Bank has invited participation in mediation to customers in these states. The notices and notice periods for mediations are as prescribed in the relevant State's legislation.

We note Rural Bank is on record with its support for a nationally legislated FDM.

- At formal FDM or in informal / voluntary negotiations, a strategy is usually agreed between the customer and Rural Bank.
- If the strategy to remedy the default is successfully achieved then no further foreclosure action takes place.
- Where the terms of the agreement are not fully achieved the customer's situation will be reviewed. Depending on the circumstances Rural Bank and the customer work together to develop a revised strategy, including the potential to extend the timeframe for remedy. Where the agreed strategy is not achieved within the original or varied timeframe, Rural Bank may initiate enforcement action against the mortgaged property. In addition to any FDM notice periods there are further notice requirements and notice periods for mortgagee action against real property as prescribed by respective state based legislations.
- Rural Bank makes every effort to work with customers to minimise the impact of adverse circumstances, sometimes taking several years to progress difficult cases through to resolution.

b. The roles of other service providers to, and agents of, financial institutions, including valuers and insolvency practitioners, and the impact of these services;

Rural Bank recognises the value of specialist and independent service providers, where it may achieve a higher quality, more timely and or cost effective outcome; or offer a degree of independence for customers and the Bank. Rural Bank has an approved panel of legal advisers, property valuers and insolvency firms that it engages who have demonstrated expertise in rural matters, are appropriately accredited or members of the relevant industry body and, where possible, are represented in relatively close proximity to our customer. Where these costs are passed to customers the Bank carefully considers the requirement for engagements.

1. Valuers

APRA Prudential Standard APS220 requires the Bank to have documented policies and procedures addressing the recognition of collateral (including the sound and prudent valuation of security). The Bank meets these requirements with policies and procedures that set out the requirements for initial valuations of its loan security items and also sets out circumstance or frequency necessitating revaluation of loan security items.

2. Insolvency Practitioners

Rural Bank will make formal insolvency appointments on a last resort basis, only after all other debt recovery avenues have been thoroughly considered and or tested. These providers have specialist skills and qualifications that we do not hold in-house.

Some example scenarios where appointments occur:

- Independent assessment, providing strategic advice on customer strategies to remedy defaults.
- Act as Receivers for the Bank for specialised security items (for example some fishing or aquaculture licences where the Bank cannot act as mortgagee in possession) to effect and

control an asset sale. Alternatively, if the Bank is dealing with an asset that it cannot physically manage, eg. a dairy or large livestock business where animal welfare is essential, the Bank may appoint Receivers to manage the business pending its sale.

- Where a business has a large number of employees or requires hands-on management, Receivers are often able to commence management at short notice to ensure maximum business value is maintained.
- At our customer's request where insolvent trading issues may arise.

c. The appropriateness of internal complaints handling and dispute management procedures within financial institutions;

In terms of traditional regulatory classification, Rural Bank customers would typically fall within the "commercial" or "small business" categorisations. Rural Bank has developed policies and procedures to meet obligations specified in ASIC Regulatory Guide RG165, the National Consumer Credit Protection Act and the EFT Code of Conduct which more relate to traditional retail banking customers.

d. The appropriateness of loan contract terms particular to the primary production industries, including loan-to-value ratios and provision of reasonable written notice.

1. Loan Contract Terms

Rural Bank have loan products and lending procedures specifically developed for primary producers with lending available on both short and long term arrangements. By thoroughly understanding customers, and the industries they operate in, we are able to tailor lending facility types, lending terms and repayment arrangements that take account unique cash flow cycles.

Rural Bank seasonal accounts provide access to working capital for shorter term funding needs. These facilities are typically provided on an annual review basis and can be secured by crops, water, livestock or farm land or combinations of these asset types.

For longer term financing needs, Rural Bank can provide loans with terms out to 15 years with these loans typically being secured by farmland. Rural Bank have a specialist internal rural valuations team to support customers longer term financing needs and leverage the research published in Rural Bank's Australian Farmland Values report to inform the reliability and durability of farmland values.

2. Loan to Valuation Ratios

As noted earlier, the existence and value of loan collateral is an important but not primary consideration.

Rural Bank has preferred loan to value ratios for various asset classes (eg. land, livestock or crops). These extension values are set in consultation with our specialist internal rural valuation team, taking into account the particular characteristics of each security eg. alternate uses, value volatility, perishability etc. The Bank rarely requires a loan to valuation ratio as a specific loan contract term. However where such a loan condition exists it is documented via the loan agreement with the customer signing as acknowledgement of this requirement.

Rural Bank uses a variety of measures as leading indicators of the customer's performance and rarely proceeds to recovery action following occurrence of a single default event. Instead, in the majority of cases, the Bank believes the customer is the best placed party to manage the business and/or properties in order to achieve improved performance.



3. Notice Periods

As noted in the discussion of Default and Foreclosure, notice periods are prescribed in various state legislations for Farm Debt Mediation and in addition there are statutory notice periods prescribed in the various state based Real Property Acts.

Conclusion

Rural Bank is proud of its association with farming families across Australia and will continue to work to achieve a bright future for agriculture and rural communities.

Our experience is that foreclosure action is rarely swift or single event driven and is the culmination of many attempts to assist customers overcome difficulties, often over many years.

The banking industry has an important role in supporting agriculture and rural growth and development. Rural Bank will continue to work with bodies such as the Australian Banker's Association to implement improvements to the products and services appropriate for the primary industries sector.

Yours sincerely,

Alexandra Gartmann
Managing Director & CEO