



National Australia Bank

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28 February 2011

Dr Ian Holland
Secretary
Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Dr Holland,

The National Australia Bank welcomes the opportunity to provide comment to the Joint Committee on Corporations and Financial Services' inquiry into *Access for Small and Medium Business to Finance*.

NAB is a member of the Australian Bankers' Association and is broadly supportive of the ABA's submission.

NAB notes that the Committee's terms of reference are similar to those of the Senate Economics References Committee's recent Inquiry into *Access of Small Business to Finance*. Our submission draws from our comments and perspectives outlined previously in this Inquiry.

If you require further information on this matter, please contact Justin Owen, Senior Manager, Government Affairs & Public Policy, t: 02 9237 9300.

Yours sincerely,

Joseph Healy
Group Executive Business Banking



Overview

NAB views the issue of financing to SMEs as a legitimate public policy matter. As Australia's largest business lender we view our relationship and our engagement with this sector as critical. NAB's commitment to this sector is unmatched by any other financial institution.

National Australia Bank has been growing and expanding its support for Australia's small and medium-sized businesses (SMEs) across a full range of banking activities. This has been at a time when much of the financial industry retreated and withdrew its support for this sector. From a NAB perspective, as a large domestic commercial bank, NAB plays a fundamental role in the economy and we have considered that support for SMEs, particularly during what have been challenging times during and post GFC, is of paramount importance.

We have total lending to business of \$185 billion, of which over \$100 billion is to SMEs. Our level of lending has grown 100% since 2005. During the height of the GFC our lending to small businesses grew by (net) \$5bn whilst in aggregate the other banks reduced lending by \$28bn. APRA Banking Statistics illustrate the fact that NAB is the market leader in supporting its business customers. In the two-year period between November 2008 and November 2010 NAB grew its business lending by \$9.5bn whilst the rest of the industry collectively reduced business lending by \$58.6bn.

Our support is recognition of the vitally important role SMEs play in the engine room of the Australian economy, and that they need financial support to grow and thrive. Good quality business lending is critical to a healthy and robust Australian economy. It supports investment, employment and wealth creation.

Profile

National Australia Bank is a financial services organisation with over 40,000 people, operating more than 1,800 branches and service centres, and responsible to nearly half a million shareholders. We operate major financial services franchises in Australia, as well as businesses in New Zealand, Asia, the United Kingdom and the United States.

Each of our brands is uniquely positioned but built on a common commitment to providing quality products and services, fair fees and charges, and relationships built upon the principles of help, guidance and advice.

Our Business Banking is integral to our organisation. We are Australia's leading business bank with over 5,000 staff nationwide. The business includes operations, marketing and financial services professionals who service the full spectrum of the business sector, from small businesses through to Australia's largest ASX-listed corporations.

We have about a 30 per cent market share of lending to small and medium businesses (SMEs) and almost 24 per cent of total business lending. We have hired over 350 additional business bankers over the past two years. We have also opened a further 11 new Business Banking Centres during this time. Based upon APRA statistics, NAB's market share of Australia's business bank lending is growing ahead of all other lenders in the Australian market.

1. NAB's commitment and engagement with the SME sector

NAB has enjoyed an active and constructive dialogue concerning the issues related to the access of SMEs to credit flows over recent years. The leadership of our Business Bank has been extensively engaged in both highlighting the existing impediments to SME lending as well as underlining the significant and ongoing efforts of NAB in supporting our SME sector.

NAB was a significant and vocal participant in the recent Senate Economics References Committee's Inquiry into *Access of Small Business to Finance*. NAB took an independent and forthright approach to the Inquiry in order to highlight our strong and enduring support for Australia's small business community.

NAB's submission drew from our long experience as the acknowledged industry leader in business lending – especially in relation to the SME sector. We highlighted our ongoing support for business throughout the GFC and also examined the impact business banking fees and charges have as an impediment to a practical and productive banking relationship.

NAB also drew the Committee's attention to concerns about the way the banking system appeared to demonstrate a bias towards lending volumes to the

household sector at the expense of Australian businesses and the potential medium and long-term economic consequences. The impact on SME lending of factors such as the capital costs for business lending as opposed to mortgages; and the extra return on equity for banks in residential mortgage lending were all issues addressed by NAB.

Our Business Bank leadership has also raised these issues and themes in the broader public domain through a range of speeches throughout 2010. In February and July our leadership addressed the American Chamber of Commerce in Australia ('AmCham') and highlighted the difficulties some SMEs are facing in accessing credit and the potential impact this can have on the Australian economy. NAB took this opportunity to discuss the regulatory environment that encourages banks to favour mortgage lending over business lending, and the potential impact of the Australian banking system's reliance on international wholesale funding. NAB returned to these themes in October in a speech to the *AB+F Corporate and Business Banking Forum*.

NAB is actively engaged with the Federal Government and Opposition on issues related to funding for SMEs. This includes regular engagements and briefings with the Federal Minister for Small Business, Senator the Hon. Nick Sherry and his predecessor the Hon. Dr Craig Emerson MP. We engage extensively with the Opposition spokesman the Hon. Bruce Billson MP and his Shadow Parliamentary Secretary, Senator Scott Ryan. NAB has previously played a leading role in the Prime Minister's Small Business Forum.

In November 2010 NAB approached the Australian Chamber of Commerce and Industry (ACCI) after the establishment of a Taskforce to oversee banking industry policy and regulatory reform on behalf of SMEs. NAB has expressed to ACCI our desire to play an active and constructive role in the Taskforce's deliberations. We look forward to an ongoing open dialogue that will allow us together to consider some of the options that may be available to assist SMEs access finance.

NAB's Business Bank leadership also recently appeared alongside the leadership of the Council of Small Business Associations of Australia (COSBOA) at the Australian Securities and Investments Commission's Summer School to address the issue of SMEs accessing funding and liquidity.

2. Lending Volumes and SMEs –Our Commitment

NAB views SMEs as the engine room of the Australian economy. The small business sector alone generates around 34 per cent of private industry value added and 48 per cent of private sector employment. The almost two-million small businesses in Australia represent around 96 per cent of all businesses and provide private sector employment for nearly 4.8 million Australians. The broader SME category employs some 7 out of every ten Australians – or 7.3 million people.

In a healthy economy, financing the productive capacity of the SME sector therefore is critical to Australia's long-term economic prosperity. Access to credit on fair terms and conditions to SMEs helps those businesses grow and in turn create employment which creates more growth and wealth. It is a virtuous cycle and reflects the key role banks play in society.

Across the SME business banking segment NAB is the clear market leader.

DBM figures for December 2010 illustrate the fact that NAB leads across nearly every market segment:

Medium Business Customers (\$5M-\$50M)

Customer Penetration (proportion of total businesses with a holding at a particular bank) – 37%

Bank Market Share (footings held at bank/total footings held at banks) – 24%

Total Share of Wallet (Footings held by customers/total footings held by customer at any financial institution) - 50%

Small Business Customers (\$1M-\$5M)

Customer Penetration – 33%

Bank Market Share – 26%

Total Share of Wallet - 66%

Microbusiness Customers (\$0M-\$1M)

Customer Penetration – 21%

Bank Market Share – 18%

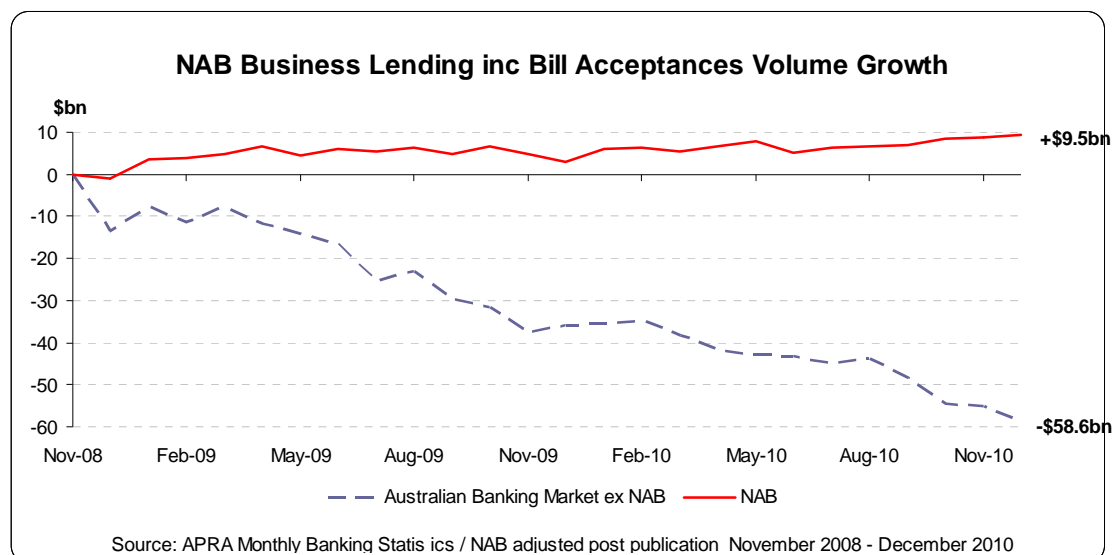
Total Share of Wallet - 66%

NAB is also the clear leader in transaction banking with over 25% of the SME market share. *(Source East & Partners)* As Australia's leading bank for SMEs we recognise the need to support this vitally important sector.

The Global Financial Crisis had a well-documented adverse effect upon the SME sector in terms of availability of credit from the broader Australian banking system. NAB awards a high premium on its long-term relationships with our customers and supporting them in good and tough times. NAB responded to these challenges for SMEs by making a strategic decision to not only maintain existing SME lending but to grow our commitment via our levels of lending and support substantially.

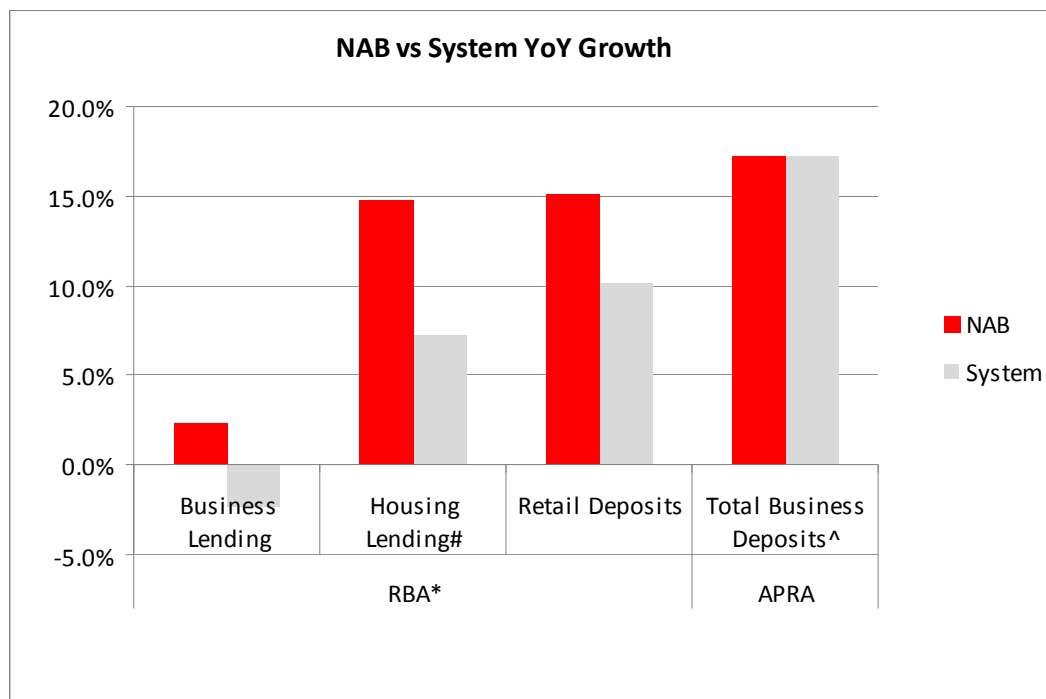
As highlighted in our *Driving the Economy* campaign, this resulted in NAB's lending to the business sector increasing by some \$9.5 billion between November 2008 and November 2010. In this same period other banks contracted their lending by some \$58.6 billion. NAB's lending to SMEs in fact has grown by over 100% since 2005.

The charts below provide further industry data of bank system lending to the business sector relative to the NAB performance.



NAB 12 month growth (%) to December 2010

	RBA			APRA
	Business Lending	Housing Lending#	Retail Deposits	Total Business Deposits
NAB	2.4%	14.8%	15.1%	17.2%
System	-2.3%	7.3%	10.1%	17.2%



NAB's commitment to the SME sector and our desire to increase our SME lending was also manifested through our opening up of new business banking centres and a considerable expansion in the number of our frontline business bankers.

NAB also in 2010 led the way in abolishing a range of fees for our business customers via a comprehensive reform package that included:

- Abolition of overdrawn fees for amounts up to \$1,000
- Abolition of fees for dishonoured cheques – by the business or someone paying the business.
- Abolition of fees for dishonoured electronic payments – by the business or someone paying the business.

- Abolition of fees for the deferral of a business' periodic payments if the business has insufficient funds.
- Abolition of the cash-handling Fee for deposits or withdrawals made over the counter.

These changes benefited nearly half a million business account holders.

3. Prudential settings and their impact on lending to SMEs

Over the last twelve months NAB has highlighted the impact changes to prudential settings and capital adequacy rules have had upon lending to SMEs in a range of public forums.

In 2007/2008 the Basel II requirements with their initial purpose of establishing an international standard for regulators to use when creating regulations about how much capital banks need to put aside to guard against financial and operational risk came into effect.

For Australia this resulted in a significant reduction in the level of regulatory capital that major banks are required to hold against their residential portfolios.

Under the new prudential settings administered by the Australian Prudential Regulation Authority (APRA) the amount of capital required to be held by banks is generally three times higher than for residential loans, and in some instances can be up to seven times higher for certain products.

The operational impact of such prudential settings is that Australia's commercial banks can do significantly more residential mortgage lending relative to business lending in terms of capital management.

NAB recognises that the motivation for these requirements is the higher risk profile associated with SME loans in comparison to residential mortgage lending. Loans to SMEs statistically have a higher default rate than residential mortgage lending.

The consequences however of such an inherent bias in favour of residential mortgage lending are significant not only for SMEs but for Australia's broader economy.

Since 2000 Australian residential mortgage lending has grown from approximately \$280bn to some \$1.2tn today. In 2000 business lending and home lending were equivalently matched. By 2010 for every \$1,000 of residential mortgage lending there was only \$600 of business lending.

NAB through its significant support for SMEs has continued to counter this trend through our strong commitment to business lending. Over half of NAB's lending continues to be to business banking customers. The Commonwealth Bank of Australia and Westpac Banking Corporation however now have over 60% of their lending in the residential mortgage sector.

NAB believes the Committee need to examine the extent to which the Basel II capital rules create a bias towards residential lending and distort capital away from the entrepreneurial and productive business banking sector.

A system whose structure serves to allocate capital away from the productive capacity of the economy – business and in particular SMEs – is bad for economic growth, employment and Australia's overall prosperity.

At the Senate Economics References Committee's Inquiry into *Access of Small Business to Finance* Government Senators issued a Minority Report with recommendations agreeing with the concerns we raised with the Committee concerning the Basel II capital adequacy rules and the effect they had upon lending to business. NAB notes that the Minority Report expressed concerns that the existing capital adequacy rules encouraged banks to favour residential mortgage lending over business lending and made a recommendation that an ongoing assessment should occur at the Commonwealth level to ensure the capital requirements are commensurate with real risk. NAB urges the Committee to further examine this recommendation.

4. Determining Risk and Lending to SMEs

In determining whether to provide credit to an SME customer NAB primarily assesses the customer's ability to repay the loan rather than the security provided by the customer. Lending is assessed principally on cashflow.

NAB also looks at a number of other factors – security, whether an SME has quality management and a sound business model.

The interest rate and pricing that NAB sets takes into account the risk that is taken in lending credit. The pricing takes into account a range of criteria including the probability of default; the capital required to be held against the loan; and the amount that can be recovered if the customer defaults on the loan.

The cost of funds is also a factor in pricing – with business lending typically reliant on wholesale funding which has increased significantly post GFC.

Each application for credit is decided by NAB on its merits individually. No decision has been made to limit the availability of credit to any particular business sector.

Loans to SMEs have a higher probability of default than retail mortgage loans. Due to this likelihood APRA requires banks to hold a significantly higher amount of capital for SME customers than retail mortgage customers: on some products up to seven times higher. Banks are also required to hold higher amounts of capital for bad debt expenses that emanate from SME lending. These prudential requirements increase the cost of providing credit to SMEs in comparison to retail mortgage lending.

Discipline around pricing for risk is a further factor that impacts upon lending to SMEs. The incorrect pricing of risk was clearly a factor in the Global Financial Crisis. The RBA notes that in the seven months leading up to 2009 bank margins declined by some 170 basis points. The risk associated with the generation of cashflow and the ability of an SME to pay back debt has become a much more pronounced issue for the banking system generally post GFC. The level of new funding available to some business customers was also reduced across the industry as a result of the reduction in external valuations of property, equipment and businesses along with corresponding impacts on loan to value ratios.

The maintenance of strong and effective risk management strategies in assessing SME credit applications is vital to Australia's economy and the maintenance of a robust, well-regulated banking system. The need for the banking industry to support our SME sector in its endeavour to grow and expand is also of critical importance. NAB successfully continues to meet this objective.

Metropolitan v Regional SME Lending

NAB provides SMEs with the same credit options in regional Australia as it does in metropolitan areas. NAB's structure for risk assessments for SMEs is identical across Australia. Our credit and risk transactions are done at the local level so there is no difference in the resourcing or treatment of SME applications. Assessments are also done on the individual business basis – NAB does not make general risk assessments across an entire industry or an entire geographic industry.

Regional Australia in fact benefits from NAB's tailored offerings for Agribusiness customers. By working with our SME customers NAB has been able to develop a range of agribusiness products and services tailored to individual business needs. NAB Agribusiness has supported regional and rural Australia for over 150 years and is Australia's number one agri bank. NAB Agribusiness continued to increase its lending to SMEs despite throughout the GFC and beyond through its network of over 600 agribusiness specialists located at over 110 locations across Australia.

As the graph below shows NAB is the clear leader in the volume of lending to SMEs in the Agribusiness sector: this trend continued in the most recent quarter.

