



8 May 2017

Mr Stephen Palethorpe
Secretary
Select Committee on Lending to Primary Production Customers
Department of the Senate
PO Box 6100
CANBERRA ACT 2600

Dear Mr Palethorpe,

The National Australia Bank (NAB) welcomes the opportunity to provide comment to the Senate Select Committee's Inquiry into Primary Production Customers.

NAB has also been involved in the preparation of the Australian Bankers' Association (ABA) submission and is supportive of its content.

We trust our commentary is of value to the Committee.

If you require any further information on our response, please contact me at

or

Yours sincerely,

JUSTIN OWEN
Senior Manager – Government Affairs & Public Policy
Business Banking

Preamble

National Australia Bank (NAB) welcomes the opportunity to participate in the Senate Select Committee's Inquiry into Lending to Primary Production Customers.

As a member of the Australian Bankers Association (ABA), NAB has participated in the ABA's consultative process and is supportive of the ABA's submission. This submission seeks to provide further commentary and guidance to the Committee on customer loan processes specific to NAB.

NAB is not only Australia's biggest lender to business; we are also Australia's largest lender to agribusiness. NAB banks one in three Australian farmers and for 155 years has proudly funded and supported Australian agribusiness. Our 548 Agri bankers based in 113 Agribusiness outlets across rural and regional Australia are part of the communities where they live. This gives us a better understanding of the issues faced by farmers and the communities they live in.

Our priority is to work constructively with our customers and support them, in good times but also in times of financial difficulty. Farming in Australia faces many challenges: fire, flood, drought, world commodity prices and movement in the Australian dollar being just some of these. As the largest funder to Australian farmers we understand these risks. We understand in Australian agribusiness there are good and bad years.

We understand that there is concern about the practice of artificially creating a Loan to Value (LVR) default – a 'constructive default'. In the clearest possible terms NAB states that it neither engages in nor condones that practice. There is no financial incentive for any bank to deliberately undervalue an asset or lose a customer.

NAB notes that many of the issues explored in this Inquiry have been reviewed in previous Inquiries.

NAB also notes that an independent review of the Code of Banking Practice was recently completed and the ABA is in the process of redrafting the Code. Consultation with representatives of agribusiness and small business stakeholders will be an important element in the development of a new Code due at the end of 2017 and fully implemented by the end of 2018. The new Code will improve the relationship between banks and agribusiness with banks providing agribusiness with more notice when loan contracts change; clearer information about credit products and lending decisions; greater notice when loan contracts change; and more time to organise alternative finance when a facility is not renewed.

NAB appreciates the opportunity to provide further context and detail as to its position to the Committee.

Summary of NAB's position

- When customers are experiencing financial difficulties it is NAB's practice to involve our Strategic Business Services (SBS) department to work with customers on a range of strategies to try and alleviate the issues facing the customers' business. This can include cash flow management disciplines, cost out initiatives, the provision of additional financial accommodation, relaxation of covenant, the deferral of amortisation and other actions.
- On occasion we utilise the services of professional advisers with the requisite skill and capacity to advise and assist our customers.
- NAB ensures that the customer's Relationship Manager remains integrally involved with the loan management even after a distressed loan becomes managed by the SBS workout team.
- We appoint receivers in a very small number of cases – we have avoided receivership for all but 1.51% of our Agribusiness workout customers in the last twelve months, representing 0.0136% of our *overall* Agribusiness book (three year average 4.1% by number and 2.57% by value of our workout book, and 0.047% of our total agri book).
- None of the cases examined by either the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Impaired Loans in 2015 or more recently by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) identified any cases of constructive default by NAB. NAB does not engage in that practice. NAB condemns the practice.
- For many years NAB has been a strong and consistent advocate for a single, national Farm Debt Mediation (FDM) Scheme. The recent implementation of a FDMA scheme in Queensland is welcome, though NAB remains of the view that the implementation by the Commonwealth Government of a single, national consistent scheme is preferable.
- A consultation paper prepared by the NSW Rural Assistance Authority in March 2017 reported a "satisfactory mediation" in more than 90% of the cases where farmers engaged fully in the mediation process.
- NAB's aim is to work with our customers in distress and stabilise and de-risk a situation with the objective of avoiding insolvency wherever possible. Occasionally a customer's situation cannot be resolved and insolvency eventuates. Almost all of these appointments involved payment default as well as a range of financial and operational defaults.

Terms of Reference

(a) The lending, and foreclosure and default practices, including constructive and non-monetary default processes

Our aim is to always work with our customers to avoid insolvency wherever possible.

We recognise the stress that customers face during times of financial hardship.

Our objective is to try and resolve the repayment of debt without enforcing loan contracts and mortgages, where ever this is possible. We try to identify issues as early as possible and engage with our customers to avoid situations that result in default, non-monetary or otherwise.

NAB ensures that the Relationship Manager remains integrally involved with the loan management even after a loan becomes managed by the workout team.

Where our customer is exhibiting higher risk profiles or experiencing financial distress and more intensive work is required we involve specialist managers who work alongside the customer's relationship manager. We highlight the ongoing involvement of the customer relationship manager, a model that we follow because our objective is always that our customer transitions back to their relationship manager.

We appoint receivers in a very small number of cases.

We appoint receivers only as a last resort. NAB appoints receivers in a very small number of cases – we have avoided receivership for all but 1.51% of our Agribusiness workout customers in the last twelve months, representing 0.0136% of our overall Agribusiness book (three year average 4.1% by number and 2.57% by value of our workout book. And 0.047% of our total agri book).

Where we do appoint a receiver to a primary producer NAB ensures that the person selected has the requisite knowledge and experience in the relevant industry to provide the best possible opportunity to sell the business as a going concern or where that is not possible, to maximise the sale price.

Breaches and defaults

Financial covenants have traditionally served as an early warning sign that the business is experiencing financial difficulty and thus prompting a conversation between the banker and the customers which, in many cases, allows for the situation to be worked through in a productive and collaborative manner.

In only one instance in the last five years did NAB initiate receivership on the basis of such a breach – a situation of special circumstance where the passing away of a sole director meant that there was an urgent need to take control of the (non-Agri) business.

In April 2017 NAB announced that financial indicator covenants will no longer be used as a trigger for default in most loan contracts for new and existing small business customers with total business lending of less than \$3 million. We believe these measures will give greater certainty to 98% of NAB business customers that fall under this threshold. NAB will apply this measure to not just new but also existing customers.

All material adverse change clauses in these small business contracts will be removed, whilst the number of specific events of non-monetary default entitling enforcement action will be limited to events such as insolvency/bankruptcy/creditor enforcement proceedings; unlawful behaviour; misrepresentation, dealing with loan security property improperly and using a loan for a non-approved purpose; loss of licence or permit to conduct business; failure to provide proper accounts or to maintain insurance (after a reasonable period); and change in beneficial control of a company except as permitted.

None of the cases examined by the PJC Inquiry into Impaired Loans or the ASBFEO Review identified any cases of constructive default by NAB

None of the submissions made by NAB customers to the PJC Impaired Loans Inquiry identified any cases of constructive or artificial default. We understand that none of the submissions made to the ASBFEO raised any instances where NAB had used a constructive default in order to enforce a loan.

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

Valuers

The members of NAB's valuation panel are independent experts, subject to the formal requirement and ethical rules of their respective professional standards.

Property valuations are initiated via an automated system which ensures that standard instructions issued. Our SME bankers do not have the scope to issue 'customised' instructions.

We believe that our panel valuers provide valuations based on the independent exercise of their professional judgement and in compliance with their ethical standards, and we would exclude them from our panel if they did not.

NAB agrees that customers should be able to choose a valuer. This should be from NAB's approved panel of valuers, currently a choice of three valuers is offered to customers for non-residential properties.

NAB supports the copy of instructions and valuation being provided to customers for valuations paid for by customers, for non-residential properties and whilst a loan is performing.

Where enforcement action is being undertaken, the valuation and the instructions given to the valuer should be kept confidential until the sale process has been finalised. NAB is comfortable with the suggestion that the valuation and the instructions could be made available to the customer after this finalisation.

NAB is an active participant in the process currently underway to develop industry-wide guidelines for the use of valuers by small business customers.

Insolvency practitioners

NAB will use restructuring and turnaround professionals to undertake Independent Business Reviews, usually either as financial due diligence to assess requests for additional lending or other support, or to assist with the development of options to improve the financial position of the business. In very rare instances it is sometimes necessary to initiate formal insolvency appointments.

NAB utilises a panel process to ensure that the restructuring and turnaround professionals that we employ meet our standards, hold appropriate professional indemnity insurance, and are members of professional associations such as ARITA and thereby subject to appropriate ethical standards.

Receivership engagements can only be taken by those holding the appropriate statutory registration. Receivers are subject statutory duties and standards, and are subject to review and supervision by ASIC.

NAB is acutely aware that insolvency appointments in the agri sector can be very challenging for our customers. On the rare occasions where it becomes necessary to make a formal appointment, we ensure that the person appointed is sensitive to the position of the customers and conduct themselves in an ethical and transparent manner.

NAB is an active participant in the process currently underway to develop industry-wide guidelines for the use of restructuring and turnaround professionals for small business customers.

(c) the appropriateness of internal complaints handling disputes and dispute management within financial institutions

NAB ensures that the Relationship Manager remains integrally involved with the loan management even after a loan becomes managed by the workout team.

We understand that some lenders have a policy that the involvement of a relationship Manager ceases after a loan becomes managed by the workout team. At NAB, the Relationship Manager continues their involvement, because:

- Our objective is always that the customer returns to mainstream banking, rather than exit the bank, and so it makes good sense to continue the relationship.
- They serve an important role by continuing to communicate with the customer with a view to finding a resolution to the issues.
- They often have specialist knowledge, and in the case of Agribusiness, an understanding of local/regional issues and seasonal and market conditions.

In addition NAB has a range of complaints handling processes including NAB Resolve which handles the majority of small business complaints. NAB Assist provides help to more than 2,000 personal and small business customers each month. Complaints coming from our agribusiness customers are largely dealt with by our specialist agri-bankers. NAB established an Office of the Customer Advocate to strengthen governance and customer disputes and associated remediation. In July 2016 NAB appointed Catherine Wolthuizen, a former Chair of the Consumers' Federation of Australia, as its Independent Customer Advocate. Customers who are dissatisfied with the outcome of a decision can have their complaint reviewed by the Independent Customer Advocate.

For many years NAB has been a strong and consistent advocate for a National Farm Debt Mediation Scheme.

NAB notes the recommendation of the PJC's Inquiry into Impaired Loans and the ASBFEO who both recommended a mandatory, nationally consistent farm debt mediation model. NAB has publicly promoted this for many years. In 2014 NAB advocated a national farm debt mediation scheme in our submission to the Commonwealth Government's Agricultural Competitiveness Green Paper.

Internal complaints processes do resolve many complaints but in some cases it becomes helpful to utilise an external process. A consultation paper prepared by the NSW Rural Assistance Authority in March 2017 reports a "satisfactory mediation" in over 90% of the cases where the farmer engaged fully in mediation.

The recent implementation of a FDMA scheme in Queensland is a pleasing development, but we believe in national, consistent coverage.

There is a need for a single, national FDM scheme. There are variations between individual State schemes, and some States have no schemes at all.

- A farmer with properties on either side of a State border will need to participate in more than one scheme (or in the case of South Australia/Victoria, no schemes as regards South Australian properties).
- Differing schemes and differing definitions make it hard to provide consistent and consolidated information.
- There are no provisions in the *Family Law Act* which deal with the various farm debt mediation schemes. This leads to inconsistencies and uncertainties when trying to settle a matter under FDM where there are family law proceedings on foot. NAB believes that a national FDM scheme could operate in conjunction with the *Family Law Act* to provide the best means of resolving these disputes.