



Group Governance & Legal
800 Bourke Street
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17 April 2018

Simon Sherwood
Senior Executive Lawyer
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By hand and by email (letter only): FSRCsolicitor@royalcommission.gov.au

Dear Mr Sherwood

ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

We refer to the Commission's letter dated 5 April 2018 which:

- noted that further hearings of the Commission will include consideration of lending for business purposes where the bank's total credit exposure to the relevant business customer is \$20 million or less (**SME Lending**);
- referred to NAB's responses of 29 January 2018 and 13 February 2018 and asked whether there was any feature of those responses which referred to SME Lending or whether NAB wished to add to its responses specifically in relation to SME Lending; and
- requested any such response by 17 April 2018.

NAB's 29 January 2018 Response

By its letter dated 15 December 2017, the Commission asked NAB and its associated entities to identify any conduct by those entities which constituted misconduct or conduct falling below community standards in the period between 1 January 2008 and 15 December 2017.

At page 4 (section 2.1) of its response, delivered on 29 January 2018 (**29 January 2018 response**), NAB:

- identified that it had undertaken a substantial documentary review covering the period from 1 January 2008 to 15 December 2017. Having regard to the scale of the Group's¹ business, the review had focussed on NAB's significant litigation reports;² reported Australian Court judgments; the Group's breach registers and underlying reports to ASIC, APRA and AUSTRAC; adverse Financial Ombudsman Service (**FOS**) Determinations relating to "systemic issues";³ significant breaches of the Code of Banking Practice reported in NAB's Annual Statements of Compliance; and reports to the Australian Information Commissioner;

¹ The Group is defined in NAB's 29 January 2018 response to include NAB Limited and its presently controlled entities.

² As set out in footnote 4 of the 29 January 2018 response, these reports record actual or potential claims against the Group in excess of AUD\$250,000 for the period 1 January 2008 to December 2016 and in excess of AUD\$1,000,000 for the period from 1 January 2017 to December 2017.

³ As set out in footnote 5 of the 29 January 2018 response, under ASIC Regulatory Guide 139, FOS is obliged to identify, resolve and report on systemic issues and serious misconduct. A systemic issue is defined in FOS's Terms of Reference as an issue that will have an effect on people beyond the parties to a dispute.

- explained that, given the compressed timeframe and greater difficulty in sourcing records that are more than 7 years old, it was possible that relevant information from these sources may not have been captured in the review; and
- stated that it was willing to provide further detail or supplementary material in due course, should the Commission request such information.

The following entries in NAB's 29 January 2018 response contain responses referable to SME Lending:

- Misconduct - Section 3.1 Item 2: Breaches of the Code of Banking Practice in relation to the procurement of guarantees:
 - See specifically: *NAB v Rice* [2015] VSC 10; *NAB v Rose* [2016] VSCA 169 and *NAB v Smith* [2014] NSWSC 1605;⁴
- Failure to meet community standards – Section 4.1 Item 6: Daintree Eco Lodge.

Those entries are re-extracted for convenience in **Annexure A**.

13 February 2018 Response and the subsequent Responses of 21 February 2018

On 2 February 2018, the Commission sought further information in relation to identified misconduct and/or possible misconduct still under investigation of which NAB became aware at any time since 1 January 2013. The 2 February request sought responses to 8 specific questions in respect of that misconduct or possible misconduct.

On 13 February 2018, NAB wrote to the Commission and:

- identified that⁵ NAB's estimate of the quickest possible timeframes to provide a *comprehensive* response to the 8 specific questions for all of the misconduct identified in NAB's 29 January 2018 response were:
 - for entries 10, 13, 15, 19, 20, 21, 22, 27, 28, 29, 30, 35, 36 and 37 in the 29 January 2018 response: 28 February 2018; and
 - for the balance of the entries in 29 January 2018 response which relate to conduct which occurred since 1 January 2013 (and any other matters identified): 13 April 2018.
- explained that the above mentioned timeframes were based on the identification, extraction/retrieval and review required as outlined in section C of the 13 February 2018 letter including, for example:
 - the review of non-significant litigation reports and customer files; and
 - the review of materials relating to non-significant breach events.
- set out, in Section C of the letter, details of the various repositories of information potentially responsive to the Commission's request, including NAB's internal risk management system, Risksmart.

On 14 February 2018, the Commission responded that the Commissioner may well be willing to accept the information about identified misconduct in the form of a report from the Risksmart system.

In response to the Commission's letter, NAB produced Risksmart reports for the period from 1 January 2013 containing instances of misconduct⁶ or possible misconduct identified from a review of its Risksmart system on 21 and 22 February 2018. The specific events from the Risksmart reports which are identifiable as being referable (Part 1) or potentially referable (Part 2)⁷ to SME Lending are listed in **Annexure B**. In the event that this is of assistance to the Commission, NAB has also enclosed on USB spreadsheets which extract only those events in the same excel format as previously provided.

By a letter dated 21 February 2018, NAB also produced a table which answered each of the Commission's 8 questions of 2 February 2018 having regard to the information reviewed by NAB since receipt of the Commission's letter of 15 December 2017 in respect of entries 10, 13, 15, 19, 20, 21, 22, 27, 28, 29, 30, 35, 36 and 37 in NAB's 29 January response and conduct recorded in the Determinations and Recommendations of

⁴ The former two cases were specifically referred to, by way of example, in the 29 January response. The latter case is of the same general character as the examples given.

⁵ Paragraph 9 of the 13 February 2018 letter.

⁶ Being conduct within one of the four identified sub-paragraphs of the definition of "misconduct" in the Terms of Reference.

⁷ Part 2 contains entries which have been identified as business lending but where it is unclear whether the total credit exposure to the relevant business customer is \$20 million or less.

the FOS and the Credit and Investments Ombudsman (the **21 February Table**). The entries in the 21 February Table which are referable (Part 1) or potentially referable (Part 2)⁸ to SME Lending are identified in **Annexure C**.

We note that entry 45, Section 3 of the 21 February Table should be updated as follows. Entry 45 was prepared by reference to a FOS Recommendation dated 10 March 2017. In the course of preparing this response, a later FOS determination issued on 19 May 2017 has been identified. In light of that determination, the response to question 8 in the 21 February Table should be substituted with the following:

FOS determined that NAB should reduce the complainant's loan balance by \$ 217,001.14 and pay the complainant \$12,000 for non-financial loss.

Conclusion

Having regard to the matters identified in NAB's 13 February 2018 letter and the time available, NAB does not otherwise wish to add to its 29 January 2018 and 21 February 2018 response, other than in the manner identified above. If, having regard to the foregoing, the Commission would benefit from the provision of further information, please let us know.

Yours faithfully



John Sharpe

General Counsel, Dispute Resolution & Regulatory Investigations

⁸ Part 2 contains entries which have been identified as business lending but where it is unclear whether the total credit exposure to the relevant business customer is \$20 million or less.

Annexure A

Extract from NAB Group's 29 January 2018 response in relation to misconduct

Q1 Misconduct	Q3(a)	Q3(b)-(d)	Q3(e)(i)	Q3(e)(ii)
<p>2. Breaches of the Code of Banking Practice in relation to the procurement of guarantees</p> <p>By way of example:</p> <p>The CCMC found that NAB breached the Code when procuring guarantees prior to 2016.</p> <ul style="list-style-type: none"> In 2015, the Victorian Supreme Court found that NAB failed to give a customer prominent notice of certain matters before execution of the guarantees, including that the customer seek independent legal and financial advice. NAB identified in 2016/17 as part of a program to review and uplift Code compliance that it may not be able to evidence that appropriate warnings and disclosures to guarantors had been made in compliance with clause 31 of the Code. 	<p>Particular instances of this conduct have been:</p> <ul style="list-style-type: none"> reported by NAB to CCMC in its annual compliance statements; the subject of CCMC investigations (including where the CCMC made findings against NAB and also where Code breaches were acknowledged by NAB and no CCMC determination was made); and the subject of court proceedings. 	<p>Banker capability issues including application of internal policies and documentation / record keeping.</p> <p>In relation to particular instances where there was a failure to provide notice of relevant matters to guarantors, the Group policies and procedures did not support full compliance with the Code, including lack of ability to demonstrate compliance with requirements regarding provision of copies of credit contracts and final letters of offer to guarantors and issues with ancillary disclosure documents as required under clause 31.4(d).</p>	<p>In particular instances, the conduct was remedied by:</p> <ul style="list-style-type: none"> NAB being unable to enforce the guarantees against customers; NAB taking remedial action which was considered appropriate by the CCMC and the CCMC being satisfied that the events which gave rise to the particular Code breaches appeared to be isolated incidents; implementing part of the Phase 1 rollout of the Guarantee Uplift Initiative in early 2017 to address breaches of disclosure requirements under clause 31.4(d); engaging the assistance of the CCMC in resolving potential breaches relating to guarantees under the Code; and settlements being reached with borrowers and guarantors. 	<p>The Group has undertaken a number of measures which include:</p> <ul style="list-style-type: none"> the Banker Capability Program which supplements the Group's policies and training to increase the awareness of the Code's requirements and the general law in relation to the taking of guarantees; updating various guarantee policies and processes, to ensure that the Group complies with its obligations under the Code, that each banker is aware of the Group's obligations under the Code, that guarantors understand the guarantee they are providing and do so voluntarily, and that the Group can monitor compliance; introducing new suitability and assessment guidelines and processes for individual guarantors to ensure unsuitable and/or vulnerable guarantors are not accepted. Additionally, the Group is developing new mandatory training for bankers on guarantees for 2018;

Q1 Misconduct	Q3(a)	Q3(b)-(d)	Q3(e)(i)	Q3(e)(ii)
	For example, judgment was entered in favour of the customer in <i>NAB v Rice</i> [2015] VSC 10, <i>NAB v Rose</i> [2016] VSCA 169.			<ul style="list-style-type: none"> rewriting the standard form Guarantee and Indemnity to align it with the proposed revised Code and to make it easier for guarantors to understand their obligations. It is scheduled to be in use from April 2018; and establishing a specific Code of Banking Practice Working Group to review issues highlighted in these cases.

Extract from NAB Group's 29 January 2018 response in relation to community standards and expectations

Q2 Community standards	Q3(a)	Q3(b)-(d)	Q3(e)(i)	Q3(e)(ii)
<p>6. Daintree Eco Lodge</p> <p>Daintree Eco Lodge was a business in far north Queensland. From 2007, the owners of the business had been exploring sale and investment options for the business. A Group employee member introduced a third party, Mr Joseph Prestia, to the customers in 2012, as a person who could help them find an equity investor for their business. The employee was unaware that Mr Prestia was a former bankrupt and had been convicted of a serious criminal offence.</p>	No.	<p>The Group considers the conduct was due to isolated causes, in that:</p> <ul style="list-style-type: none"> the Group employee did not perform any due diligence on Mr Prestia's suitability before sharing his details with the customers; and the Group believes this is the only instance where it has passed Mr Prestia's details to a customer. 	<p>The Group accepts that further investigation should have been undertaken or a clear warning given to the customers that no investigation had been undertaken.</p> <p>The Group and the customers have since entered into a settlement.</p>	The Group confirmed in October 2017 that it will not be dealing with Mr Prestia nor providing his details to any customer of the Group.

Annexure B: Events identified in Risksmart reports

1 Part 1: Entries relevant to SME lending

Event numbers from 2013 Risksmart extract

1 867282	2 875937	3 907758
4 866253	5 877596	6 1566318
7 1566616	8 829071	9 880896
10 882444		

Event numbers from 2014 Risksmart extract

11 916883	12 927044	13 959233
14 1589281	15 1595905	16 1601659
17 1601942	18 1603184	19 916732
20 943176	21 973579	22 1588724

Event numbers from 2015 Risksmart extract

23 1013774	24 1610148	25 999179
26 1004508	27 1612056	28 1612681
29 1612791	30 1612985	31 1613218
32 1613759	33 1615571	34 1615689
35 1618244	36 1617232	37 1618503
38 1618738	39 1619920	40 1620769
41 1622892	42 1623556	43 1623798
44 1623927	45 1624682	46 1625053
47 1625085	48 1625179	49 1625272
50 1625441	51 1625731	52 1625734
53 1625861	54 1625870	55 1625895
56 1016184		

Event numbers from 2016 Risksmart extract

57 29984507	58 28421543	59 32541460
60 28140051	61 32571764	62 29363469

63 29581092	64 30136561	65 30161020
66 30166793	67 30263514	68 30484978
69 31587588	70 31664523	71 31697486
72 31723713	73 31975339	74 32048650
75 32573287	76 33313747	77 33315260
78 33495563	79 33513781	80 33840540
81 34310074	82 34317649	83 35034725
84 35062477	85 35082968	86 35359071
87 35369502	88 35627486	89 35700112
90 26246912	91 26296356	92 24286115
93 24527314	94 25171630	95 25438326
96 25923665	97 26058551	98 26117236
99 26747651	100 26964948	101 27561937
102 27629000	103 27931101	104 28235561
105 28375052	106 28563561	107 28734586
108 28794771	109 29562667	110 29594256
111 29733873	112 30137852	113 30156202
114 30834021	115 31138393	116 31972410
117 32302608	118 32515385	119 32547139
120 32569491	121 32586795	122 32592022
123 32604617	124 32608263	125 32639122
126 33272347	127 34834582	128 35378581
129 35380512	130 27566741	
Event numbers from 2017/2018 Risksmart extract		
131 36626670	132 38176242	133 40722230
134 41548948	135 42580747	136 47589387
137 47589884	138 47709524	139 36187041
140 36198193	141 36354819	142 36366296
143 36415240	144 36471844	145 36477075

146 36492884	147 36768616	148 36838908
149 36839765	150 36854700	151 36900963
152 38450426	153 37128999	154 40080850
155 40275769	156 40532511	157 40548239
158 40673486	159 41175462	160 41186192
161 41423746	162 41436776	163 39493260
164 39746925	165 41662914	166 41910575
167 46038731	168 45677945	

2 Part 2: Entries relevant to business lending⁹

Event numbers from 2013 Risksmart extract

1 1552410	2 1565221	3 1568452
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Event numbers from 2014 Risksmart extract

4 927356	5 944997	6 950971
7 951739	8 1003788	9 1579760
10 1580090	11 1581883	12 1582808
13 1583328	14 1585291	15 1587776
16 1588658	17 1588895	18 1589972
19 1590051	20 1590319	21 1590445
22 1591489	23 1591833	24 1592484
25 1592593	26 1592713	27 1593583
28 1593586	29 1594119	30 1594289
31 1594582	32 1595128	33 1595368
34 1595453	35 1595978	36 1596052
37 1596566	38 1597173	39 1597317
40 1597402	41 1598786	42 1599133
43 1599531	44 1601160	

⁹ As noted above, this list includes entries which have been identified as business lending but where it is unclear whether the total credit exposure to the relevant business customer is \$20 million or less.

Event numbers from 2015 Risksmart extract

45 905544	46 1014339	47 1611449
48 1611643	49 1611857	50 1611889
51 1612211	52 1613027	53 1620811
54 1622530		

Event numbers from 2016 Risksmart extract

55 32499087	56 28496813	57 35418048
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Event numbers from 2017/2018 Risksmart extract

58 36009262	59 36009680	60 36199520
61 36226255	62 36351804	63 36542019
64 36619106	65 36621054	66 36631335
67 36674564	68 36906197	69 36937830
70 37114143	71 37118155	72 37126416
73 37263250	74 37453742	75 37460091
76 37463985	77 37660346	78 37671206
79 37766494	80 37931523	81 38001663
82 38005211	83 38157205	84 38181849
85 38209003	86 38425773	87 38569277
88 38709677	89 38864392	90 38882310
91 39060763	92 39061520	93 39177742
94 39297928	95 39298145	96 39309930
97 39310839	98 39312578	99 39375927
100 39495374	101 39500735	102 39838432
103 39929501	104 40316552	105 40325485
106 40376952	107 40392032	108 40393217
109 40416910	110 40475220	111 40533115
112 40537245	113 40539969	114 40572402
115 40576211	116 40588798	117 40660720
118 40687370	119 40696048	120 40713100

121	40718893	122	40729345	123	40770815
124	40772576	125	40977172	126	40988811
127	41212581	128	41377115	129	41468834
130	41471926	131	41512057	132	41828244
133	41831196	134	41890721	135	41904772
136	41912161	137	41912381	138	42027891
139	42029808	140	42431864	141	42457903
142	42793542	143	42879206	144	42910043
145	42912217	146	42915584	147	45001394
148	45026270	149	45030705	150	45568714
151	45732649	152	45800655	153	45809713
154	45898009	155	45917229	156	45925933
157	45926489	158	46179492	159	46221879
160	46396506	161	46566969	162	46573961
163	46622220	164	46773474	165	46803873
166	46988123	167	47196981	168	47214135
169	47228796	170	47292572	171	47668388
172	47673866	173	47682425	174	47715064
175	47772627	176	47826613	177	47868231
178	47967060	179	48236544	180	37558341

Annexure C: Specific FOS and CIO matters

The entry numbers in the below table are to the items identified in section 3 of the 21 February Table.

1 Part 1: Entries relevant to SME lending

Items in 21 February Table	FOS case number
1	279195
6	313311
7	316370
8	328513
10	330410
11	339684
12	342454
14	342990
17	353051
19	365426
32	394665
45	443238
49	453554
60	14/4328 (CIO case number)

2 Part 2: Entries relevant to business lending¹⁰

Items in 21 February Table	FOS case number
36	421716

¹⁰ As noted above, this list includes entries which have been identified as business lending but where it is unclear whether the total credit exposure to the relevant business customer is \$20 million or less.