

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

***FOURTH ROUND OF PUBLIC HEARINGS: EXPERIENCES WITH FINANCIAL SERVICES
ENTITIES IN REGIONAL AND REMOTE COMMUNITIES***

SUBMISSIONS OF NATIONAL AUSTRALIA BANK – SMITH CASE STUDY¹

A. INTRODUCTION

1. NAB's case study related to its conduct in respect of Kenneth Noel Smith and Deborah Allison Smith (the **Smiths**). NAB's conduct in respect of the Smiths was addressed in a statement and supplementary statement of Ross McNaughton², who gave evidence at the hearing. Mrs Smith also provided a witness statement to the Commission and gave evidence at the hearing.³
2. This submission addresses the findings proposed by Senior Counsel Assisting in relation to the NAB case study during her closing submissions on 6 July 2018.
3. At the outset, NAB notes that Senior Counsel Assisting has not proposed any findings that NAB has engaged in any misconduct with respect to the Smiths, or at all.
4. NAB also notes that, to the extent that this case study focused on NAB's conduct at the farm debt mediation with the Smiths in September 2013, Senior Counsel Assisting has not proposed any finding that NAB engaged in any conduct falling below community standards and expectations.
5. Having regard to the closing submissions of Senior Counsel Assisting, this submission focuses on the findings which Senior Counsel Assisting has proposed may be open to the Commission relating to the issues of hardship assistance and the charging of default interest. For the reasons set out in these submissions, NAB's position is that it has not engaged in any conduct falling below community standards and expectations in its dealings with the Smiths, and the Commission should not make any of the findings which Senior Counsel Assisting has proposed as being open.

B. DESCRIPTION OF NAB'S CONDUCT WITH RESPECT TO THE SMITHS

6. Before turning to the findings which Senior Counsel Assisting submitted are available on the

¹ Filed by NAB pursuant to the grant of leave given by the Commissioner pursuant to paragraph 1(d) of the order granting leave to appear dated 19 June 2018.

² WIT.0001.0069.0001, Statement of Ross Hugh McNaughton dated 18 June 2018 with Exhibit RHM-2 tendered as Exhibit 4.112 (**McNaughton Statement 2**), in response to Rubric 4-18; WIT.0001.0071.0001, Statement of Ross Hugh McNaughton dated 25 June 2018 tendered as Exhibit 4.113 (**McNaughton Supplementary Statement**), in response to Rubric 4-18.

³ WIT.0001.0066.0001, Statement of Deborah Allison Smith dated 22 June 2018 with Exhibit DS tendered as Exhibit 4.110 (**Smith Statement**).

evidence, it is necessary to provide an overview of NAB's conduct with respect to the Smiths.

The Smiths' facilities with NAB and their referral to SBS

7. In respect of the events the subject of this case study, the Smiths became customers of NAB in February 2008.⁴ The Smiths had two primary facilities with NAB: a NAB Business Markets – Fixed Rate Loan, which became a Flexible Rate Loan in 2011 (which at all times had a limit of \$3.1 million), and a Farmer's Choice Farm Management Account Overdraft (with a limit initially of \$250,000, later increased to \$350,000 in 2009, \$375,000 in 2010, \$450,000 in 2011 and \$530,000 in 2012).⁵ The Smiths provided securities to NAB in the form of a registered mortgage over their Limbri Downs property (the **Hughenden Property**), a registered mortgage over their Oakvale property (the **Pentland Property**), a livestock mortgage, an equipment and loan mortgage, and a Bill of Sale.⁶
8. In August 2012, NAB first gave consideration to transferring the Smiths' file to its Strategic Business Services team (**SBS**), a team with specialist expertise within NAB dealing with customers who are, or may be, in financial difficulty. That consideration occurred in circumstances where: (a) the Smiths' conduct of their overdraft account was in breach of a monetary obligation for more than 30 days; (b) covenants on borrowing had been breached by the Smiths and not remedied within 30 days; and (c) the quality of financial information provided by the Smiths to NAB was insufficient to allow NAB to conduct an informed credit assessment.⁷
9. SBS did not accept the Smiths' file for referral at that time because NAB considered that the Smiths still ran a viable business, that both properties had received significant rainfall over the past two years (allowing feed reserves to be built up), and that funds were due from a cattle sale to clear the excess on the overdraft account. NAB considered that a temporary increase in the overdraft account limit would provide the customers with assistance pending recommencement of income from hiring out a Dozer and the next cattle sale.⁸ As noted in paragraph 8 above, NAB provided the Smiths with an increase in their overdraft limit to \$530,000 in August 2012.
10. In November 2012, the Smiths' file was referred to SBS for categorisation and was accepted by SBS. Acceptance occurred in circumstances where: (a) NAB now considered the Smiths were unlikely to meet their loan obligations in full (including because the Smiths had no ready plans

⁴ McNaughton Statement 2 at [64].

⁵ McNaughton Statement 2 at [68]. The Smiths also had an equipment loan for \$78,207.60, and personal credit cards: McNaughton Statement 2 at [69].

⁶ McNaughton Statement 2 at [70].

⁷ McNaughton Statement 2 at [72]. The Smiths were required to provide NAB with financial information requested by it pursuant to, among other things, clause 3 of the General Conditions in the NBM Agreement and clause 3 of the General Conditions in the Overdraft Agreement (as those agreements are defined in McNaughton 2 at [68]); and in particular were required to provide financials for the financial year ending 2011 by 30 June 2012, pursuant to the Business Letter of Advice dated 19 September 2011 (McNaughton Statement 2, tab 28, NAB.005.451.0039).

⁸ McNaughton Statement 2 at [73]-[75].

to sell stock to meet payments, their overdraft was again overdrawn, and they were no longer receiving income for the hiring out of a Dozer); (b) covenants on borrowings had been breached and not remedied within 30 days; (c) the quality of the financial information provided by the Smiths to NAB was insufficient to enable an informed credit assessment; and (d) NAB considered that there were ongoing shortfalls in meeting budgets and issues in proactively addressing cash flow requirements by the Smiths.⁹

11. NAB accepts that the difficulties the Smiths were facing at this time were, at least in part, due to external factors such as the ban on live cattle export put in place by the Australian Government, a flood at their Pentland Property which (for a period of time around August 2012) impacted on their ability to bring cattle to market, and dry conditions at their Hughenden Property which was about to be declared as being in drought.¹⁰

Referral to SBS to farm debt mediation

12. Following the referral of the Smiths to SBS, they were assigned an Impaired Asset Manager (**IAM**), Bruce Starky.¹¹ Mr Starky has remained the Smiths' IAM since that time.¹² Mr Starky is an Associate Director (Agribusiness Specialised) within SBS based in Queensland, with more than 15 years' experience in that role, and accountancy and then agricultural lending experience dating to the mid-1980s.¹³ He is part of a dedicated team of agri-specialists within SBS which has been in place since at least 2005.¹⁴ In the case of the Smiths, Mr Starky worked with their local relationship bankers,¹⁵ who have been located at NAB's Hughenden branch (in proximity to the Hughenden Property).¹⁶
13. As at November 2012, the Smiths were being advised by a government funded Rural Financial Counsellor, John Swain. From November 2012 to April 2013, NAB sought to work with Mr Swain to put in place a strategy to seek to rehabilitate the Smiths' loans and 'repatriate' those loans out of SBS and into the sole management of their local relationship banker.¹⁷ Such an approach is consistent with SBS' ultimate objective of developing a strategy, wherever possible, of rehabilitating the loans of agricultural customers in financial difficulty into performing loans, repatriating that customer to their relationship banker, and maintaining NAB's relationship with that customer.¹⁸

⁹ McNaughton Statement 2 at [76]-[79]. The Smiths were required to provide NAB with financial information requested by it pursuant to, among other things, clause 3 of the General Conditions in the NBM Agreement and clause 3 of the General Conditions in the Overdraft Agreement (as those agreements are defined in McNaughton 2 at [68]); and in particular were required to provide financials for the financial year ending 2011 by 30 June 2012, pursuant to the Business Letter of Advice dated 19 September 2011 (McNaughton Statement 2, tab 28, NAB.005.451.0039).

¹⁰ Smith XXN at T3546.47-T3547.45; McNaughton XXN at T3585.1-26.

¹¹ McNaughton Statement 2 at [81].

¹² McNaughton Statement 2 at [83].

¹³ McNaughton Statement 2 at [84].

¹⁴ McNaughton Statement 2 at [45].

¹⁵ McNaughton Statement 2 at [55] to [57].

¹⁶ Smith XXN at T3538.35-46; McNaughton XXN at T3596.28-29.

¹⁷ McNaughton Statement 2 at [88] -[93].

¹⁸ McNaughton Statement 2 at [52].

14. Following a review of the file, Mr Starky considered that the Smiths should be in a position to clear their arrears by January 2013, pending the receipt of further information. From November 2012 until March 2013, NAB engaged with Mr Swain and sought information about the Smiths' position from Mr Swain, and regularly reviewed the position of the Smiths' facilities.¹⁹
15. In March 2013, NAB decided to invite the Smiths to a farm debt mediation, including in circumstances where: (a) their overdraft account continued to be consistently over its limit, with arrears of \$80,000; (b) their Rural Financial Counsellor had learnt that there was an error in the order of \$100,000 to \$150,000 in the figures the Smiths had provided to him as to debt levels; (c) their Rural Financial Counsellor was continuing to try to obtain reliable information from the Smiths; (d) Charters Towers Regional Council had resolved to sell the Smiths' Pentland Property because rates had not been paid; and (e) NAB understood that the Smiths were also in arrears to the Australian Taxation Office.²⁰
16. In April 2013, NAB invited the Smiths to attend a farm debt mediation, pursuant to the Queensland Farm Finance Strategy which NAB had voluntarily adopted.²¹ In doing so, NAB provided the Smiths with details of independent advice services that they could turn to (including Mr Swain and Denis McMahon (the latter from Legal Aid's Farm and Rural Legal Service)) and suggested that the Smiths immediately take independent advice in relation to the matter.²² The Smiths agreed to attend mediation.
17. In July 2013, NAB followed up its mediation proposal with Mr Swain, noting that the mediation should be held at the earliest possible time given the Smiths were incurring interest at default rates.²³
18. Prior to the mediation, the Charters Towers Regional Council was taking steps towards enforcing against the Smiths by selling their Pentland Property. NAB corresponded with the Council and Mr Swain in relation to the Council's notice of intention to sell, and then paid the approximately \$13,000 in outstanding rates owed by the Smiths to the Council (which was debited to the Smiths' overdraft).²⁴
19. On 18 September 2013, the Smiths and NAB attended a farm debt mediation in Townsville. The mediator was a Brisbane-based barrister. The Smiths were represented by both Mr McMahon of Legal Aid and Mr Swain.²⁵ The mediator certified that NAB and the Smiths participated in the mediation in good faith.²⁶
20. At the conclusion of the mediation, the Smiths and NAB executed a Forbearance Deed. The

¹⁹ McNaughton Statement 2 at [88]-[92].

²⁰ McNaughton Statement 2 at [93].

²¹ McNaughton Statement 2 at [59].

²² McNaughton Statement 2 at [94]; McNaughton Statement 2, tab 54, NAB.148.032.8970.

²³ McNaughton Statement 2 at [96].

²⁴ McNaughton Statement 2 at [95].

²⁵ McNaughton Statement 2, tab 58, NAB.005.451.1017; McNaughton Supplementary Statement at [5].

²⁶ McNaughton Statement 2 at [97].

terms of that Deed included: (a) NAB agreeing, so long as the Smiths met their obligations under the Deed, that the amount owing by the Smiths would be calculated by not applying default interest from the date of the Deed,²⁷ and that \$50,000 would be rebated to the Smiths on account of interest accrued prior to the date of the Deed; (b) NAB agreeing, between October 2013 and September 2014, to pay the Smiths (and debit from their facilities) a total of \$275,000 to meet monthly operating expenses of the Smiths' business (as specified in the deed) and up to \$20,000 for the costs of marketing one of their properties for sale; (c) the Smiths being given until 30 September 2014 to pay to NAB the amount outstanding under the facilities, with the Smiths to choose to market for sale either the Hughenden Property or Pentland Property and commence doing so by 1 March 2014; (d) the Smiths agreeing to keep NAB informed in relation to the progress of the marketing and sale, including by provision of a copy of an agency agreement, marketing campaign and fortnightly updates on the progress of the sale; and (e) the Smiths agreeing to pay to NAB all net sale proceeds from the sale of stock, with interim payments on 30 April, 30 May and 30 June 2014 up to a total amount of \$800,000.²⁸

Period following farm debt mediation

21. Ultimately, the Smiths did not comply with a number of their obligations under the Forbearance Deed. This included not making the interim repayments to NAB on the dates required or at all, not (to NAB's knowledge) commencing the marketing for sale of either the Hughenden Property or Pentland Property, and not providing any marketing campaign or fortnightly updates on the progress of the sale to NAB.²⁹ Particularly having heard Mrs Smith's evidence during the Commission hearing, NAB accepts that the Smiths experienced legitimate difficulties in complying with those obligations because the Hughenden Property continued to be in drought in 2014, and the Pentland Property was dry and then subsequently in drought in 2015.³⁰
22. While NAB advanced amounts to the Smiths pursuant to the Forbearance Deed in excess of \$147,000 in the period October 2013 to March 2014, NAB ceased making such payments from May 2014 following the Smiths' non-compliance with the Forbearance Deed, and difficulties in obtaining responses and information from the Smiths including about the marketing for sale of one of their properties.³¹
23. From May 2014 onwards, NAB engaged with a variety of different advisors acting for the Smiths. From May 2014 to August 2014, NAB engaged with Rachel Bock, a Rural Financial Counsellor who had taken over the Smiths' case file from Mr Swain. The correspondence

²⁷ While Senior Counsel Assisting's closing submissions did not make reference to NAB's agreement to forbear from charging future default interest (see Senior Counsel Assisting's closing address at T4120.29-31), NAB considers that term to be a significant element of the overall bargain struck with the Smiths at the farm debt mediation.

²⁸ McNaughton Statement 2 at [99]; NAB.005.451.1023.

²⁹ McNaughton Statement 2 at [102], [106]-[112].

³⁰ Smith XXN at T3547.34-36 and T3557.29-33; McNaughton XXN at T3600.18-20.

³¹ McNaughton Statement 2 at [103]-[105].

included NAB seeking (and to a large extent, not receiving) information about the status of marketing and advertising of a property and planned cattle sales, and potential refinancing opportunities for the Smiths.³²

24. From August 2014 to March 2015, NAB engaged with a new advisor acting for the Smiths, Neil Fleming of ODTTA Enterprises, Business & Finance Consultants located in Cobram, Victoria. During that period, NAB had difficulty obtaining responses to communications and information requested. This included NAB making several requests for National Livestock Identification Scheme database information in relation to the movement of the Smiths' cattle, which was not provided.³³
25. In November 2015, NAB was contacted by a new advisor to the Smiths, John Carey, an accountant. Mr Carey indicated that the Australian Taxation Office had commenced bankruptcy proceedings against the Smiths and he was assisting them. NAB received no further communication from Mr Carey.³⁴
26. From November 2015 to March 2016, NAB engaged with a new advisor to the Smiths, Daniel Simonfi of DJ Partners. Mr Simonfi indicated he was urgently dealing with the 'ATO matter'.³⁵ Mr Simonfi then raised concerns about the welfare of the Smiths' cattle. With Mr Simonfi's agreement, NAB retained an advisor, Kevin Currie of Ray White Townsville, to visit the Smiths' properties, inspect the condition of the cattle and report back. Based on Mr Currie's report, NAB paid \$18,452 directly for the costs of a trailer of hay for the Smiths' cattle (debited to the Smiths' account).³⁶
27. Mr Simonfi then raised a number of suggestions with NAB to seek to resolve the situation with the Smiths, including the prospect of NAB advancing further funds to feed the cattle with a view to the Smiths making significant repayments to NAB from the sales of the cattle once they were again in a good condition.³⁷ NAB decided to investigate the feasibility of that suggestion and agreed with Mr Simonfi that it would appoint National Consulting Group (a consulting arm of Ferrier Hodgson) to visit the properties, inspect the cattle and pastures, and report back.³⁸ However, the Smiths cancelled a scheduled site visit by National Consulting Group and did not engage with subsequent attempts to reschedule. Around this time in about May 2016, NAB also became aware that signs had been put up at the entrances to the Hughenden Property stating 'Entry by Invitation Only or Trespass Applies' and citing a number of legal authorities relating to trespass.³⁹

³² McNaughton Statement 2 at [109]-[116].

³³ McNaughton Statement 2 at [117]-[121]. NAB's entitlement to this information arose, among other things, from clause 7(d) of the Forbearance Deed and clause 12.5 of the Stock Mortgage (see McNaughton Statement 2, tab 33, NAB.148.018.8915).

³⁴ McNaughton Statement 2 at [123].

³⁵ McNaughton Statement 2 at [124].

³⁶ McNaughton Statement 2 at [125]-[127].

³⁷ McNaughton Statement 2 at [128]; McNaughton Statement 2, tab 107, NAB.148.008.7753.

³⁸ McNaughton Statement 2 at [129].

³⁹ McNaughton Statement 2 at [130].

28. In May 2016, Mrs Smith informed NAB that Rodney Culleton was now their advisor. NAB has never received any communication from Mr Culleton.⁴⁰ In July 2016, Mr Simonfi indicated that he was no longer engaged by the Smiths, and referred to difficulties that he had encountered in obtaining instructions from the Smiths and in advising them.⁴¹

Current position with respect to the Smiths

29. In January 2018, NAB wrote to the Smiths summarising the efforts taken to that date to find a satisfactory resolution to their situation, and again invited them to attend mediation.⁴² To date, the Smiths have not indicated whether they wish to accept the invitation to mediate.⁴³ Mrs Smith's evidence to the Commission was that the Smiths remain non-committal about attending the mediation offered by NAB.⁴⁴
30. The Smiths presently remain on both their properties. NAB remains ready and willing to again mediate with the Smiths. NAB recognises that, in the particular circumstances of the Smiths, mediation should involve discussion of a resolution which involves relief from past and future default interest for the Smiths so as to enable the Smiths to refinance, for the Smiths to remain in possession of one of their properties, and have cattle from which to earn an income.⁴⁵

C. NAB'S RESPONSE TO THE AVAILABLE FINDINGS PROPOSED BY SENIOR COUNSEL ASSISTING

31. It is appropriate to deal first with the second proposed finding (which occurs first in time).

Proposed finding 2 – It is open to the Commissioner to find that 'by failing to notify the Smiths of the bank's hardship policy in August 2012, when the Smiths' business had suffered as a result of flooding at Oakvale, NAB engaged in conduct falling below community standards and expectations'.

NAB provided the Smiths with assistance in August 2012

32. In considering the finding proposed by Counsel Assisting, it is critical to note at the outset that NAB did in fact provide the Smiths with assistance in August 2012. Any examination of NAB's conduct must be viewed in that light.
33. The finding which Senior Counsel Assisting proposes as open to the Commission appears to be based on the following conclusion:

Notwithstanding that their financial difficulties were assessed as being temporary and

⁴⁰ McNaughton Statement 2 at [131].

⁴¹ McNaughton Statement 2 at [132].

⁴² McNaughton Statement 2, tab 121, NAB.148.025.4676.

⁴³ McNaughton Statement 2 at [134]-[137].

⁴⁴ Smith XXN at T3563.44 – T3564.21.

⁴⁵ McNaughton Statement 2 at [177]; McNaughton XXN T3604.5-16.

*caused by a natural disaster, the Smiths were not informed of NAB's hardship policy or offered any relief at the time.*⁴⁶

34. Further, during his cross-examination, Counsel Assisting raised the following with Mr McNaughton:

*one option for a file like this where there are cash flow problems, some of which are caused by reason of unfortunate circumstances and circumstances outside the control of the borrower might be, rather than to charge default interest on the overdrawn amounts of the overdraft, to increase the limit of the overdraft to bring it back into order.*⁴⁷

...

*an option that might be attractive – to the bank so that it doesn't have an impaired loan, and to the customer, so that they continue to get through this difficult patch that they've found themselves in – is to restore the facility to a higher limit so it is now in order, which avoids default interest, and gives them some headspace to get through – some head room to get through the troubled patch.*⁴⁸

35. The option described by Counsel Assisting is precisely what NAB did for the Smiths in August 2012. At that time, NAB assisted the Smiths by providing an increase in the facility limit on their overdraft to \$530,000, to ensure they were no longer in default under the overdraft and had additional working capital for their business.⁴⁹ That increase followed their relationship banker noting that '*Applicants are likely to require an extension to working capital facilities*',⁵⁰ an agribusiness credit manager then noting that a temporary increase in the Smiths' working account would provide them with assistance pending recommencement of income from hiring out a Dozer and a cattle sale, and an SBS executive agreeing with the proposed approach.⁵¹
36. The increase in the facility limit in August 2012 to assist them with their cash flow difficulties was the fourth occasion where NAB had provided the Smiths with an increase on their overdraft (see paragraphs 7 and 9 above).
37. Having regard to this important context and the other matters noted below, NAB does not consider a finding that its conduct fell below community standards and expectations should be made. Insofar as it proposed that, even though NAB in fact provided the Smiths with assistance in August 2012, NAB engaged in conduct falling below community standards and expectations because NAB failed to *notify* the Smiths of the bank's financial hardship policies at that time,

⁴⁶ Senior Counsel Assisting's closing address at T4119.36-38; emphasis added.

⁴⁷ McNaughton XXN at T3587.7-11.

⁴⁸ McNaughton XXN at T3588.26-30.

⁴⁹ McNaughton Statement 2 at [68].

⁵⁰ McNaughton Statement 2, tab 38, NAB.005.514.0001.

⁵¹ McNaughton Statement 2 at [74]-[75].

NAB also does not consider that finding should be made. Before turning to NAB's reasons for this position, it is necessary to provide some background as to NAB's legal obligations and policies regarding financial hardship.

Legal obligations and policies

38. For persons in the position of the Smiths as at August 2012, the primary legal obligation for NAB directed to financial hardship was contained in the Code of Banking Practice (**Code**). At the time, the Code provided as follows at clause 25.2:⁵²

With your agreement, we will try to help you overcome your financial difficulties with any credit facility you have with us. We could, for example, work with you to develop a repayment plan. If, at the time, the hardship variation provisions of the Uniform Consumer Credit Code could apply to your circumstances, we will inform you about them.

39. In addition to its legal obligation, NAB also has financial hardship policies in place to provide assistance to borrowers who are unable due to illness, unemployment or other reasonable cause, to meet their obligations under their existing credit contract and who reasonably expect to be able to discharge their obligation if the terms of the contract were changed.⁵³ NAB provides extensive information to customers about its hardship policies, among other things, on its website: see <https://www.nab.com.au/personal/help-and-guidance/financial-hardship>.

Financial hardship notification in August 2012

40. NAB does not consider that its conduct in respect of *notifying* the Smiths of its financial hardship policy fell below community standards and expectations for the following reasons.
41. First, NAB submits that there is insufficient evidence before the Commission to justify a finding that the Smiths were not informed about NAB's financial hardship policy prior to or in August 2012. The entirety of the evidence on the point appears to be the following exchange between Counsel Assisting and Mrs Smith during examination in chief: "*Can you recall anybody from the bank at any point speaking to you about hardship arrangements?---No*".⁵⁴ There is no evidence from Mr Smith as to whether he was informed about NAB's hardship arrangements. There is no evidence from the Smiths' advisors at the time about this matter. In circumstances where NAB was not asked to address the issue in Mr McNaughton's written statement, there is also no evidence from NAB before the Commission on the issue (including from the relationship banker who was primarily interacting with the Smiths in August 2012 or from documentary evidence).

⁵² Up until 1 February 2014, the relevant version of the Code was known as the 'modified 2004 Code' version. NAB does not consider that the provisions of the *National Consumer Credit Protection Act 2009* (Cth) are applicable in the present circumstances.

⁵³ See for example McNaughton Statement 2, tab 18, NAB.005.191.0559; Exhibit 4.119, NAB.106.001.0679 (Hardship Notice HAR102). See also McNaughton Statement 2, tab 19, NAB.005.291.0001.

⁵⁴ Smith XXN at T3564.31-32.

NAB submits that the Commission should not be satisfied on the evidence before it that the Smiths were not informed of hardship arrangements in or prior to August 2012.

42. Second, even if the Commission does find that the Smiths were not informed about NAB's hardship policy in or prior to August 2012, there is no suggestion that NAB breached its legal obligations (e.g. under the Code), or otherwise engaged in misconduct. The absence of misconduct should be an important input into an assessment of whether community standards and expectations have been breached.⁵⁵
43. Third, even if the Commission finds no notification about the existence of NAB's hardship policy was given to the Smiths in or prior to August 2012, NAB does not consider that amounts to a breach of its policies. NAB does not understand Senior Counsel Assisting to contend otherwise.
44. Fourth, as at August 2012, NAB understood that the Smiths were about to clear the excess in their account imminently. The notes from the Smiths' relationship banker at the time indicated that '*While the wet season has hampered applicants efforts to get cattle to market it also has provided ample feed for retained cattle to continue to grow*', that the customer was proposing to sell cattle ready for market, and that '*imminent cattle sales are projected to clear the current excess on their account*'.⁵⁶ There was no suggestion that the Smiths were facing any future difficulty in meeting their obligations, once they had imminently cleared their excess.
45. Moreover, and as noted at paragraphs 32 to 37 above, the Smiths were in any event given assistance by NAB in August 2012 so that they were no longer in default under their overdraft and had additional working capital for their business.
46. In summary, even if the Commission considers that it has a sufficient basis to find that the Smiths were not notified of NAB's financial hardship policy in or prior to August 2012, such a lack of notification did not amount to breach of any legal obligation or internal NAB policy requirement, and in any event NAB *did* proactively provide the Smiths with assistance through an increase on their overdraft at that time. In all the circumstances, NAB submits that the Commission should not find that NAB's conduct in this regard fell below community standards and expectations.

Proposed finding 1 – It is open to the Commissioner to find that 'by charging default interest to the Smiths for in excess of five years on one facility and in excess of six years on the other, in circumstances where the Smiths' business was affected by more than one natural disaster, NAB engaged in conduct falling below the standards and expectations of the community'.

47. NAB does not consider that it has engaged in conduct falling below the standards and

⁵⁵ NAB notes that this is particularly so having regard to the definition of misconduct in the Commission's Terms of Reference, which includes conduct that is a breach of a professional standard or a recognised and widely adopted benchmark (which NAB considers would include the Code).

⁵⁶ McNaughton Statement 2, tab 38, NAB.005.514.0001.

expectations of the community in its approach to applying default interest to the Smiths, for the following reasons.

48. First, NAB does not consider that there is anything intrinsically inappropriate with the application of default interest to the facility of a customer in default, whether that customer is an agricultural customer or otherwise. Default interest is a standard feature of most NAB business lending contracts. It is customary within the banking industry to apply it to a customer in default, and, in NAB's view, it is a legitimate term to include in a business lending contract.
49. Second, a default interest term in a business lending contract is a term voluntarily agreed to between the relevant customer and NAB, and is a term that is appropriately highlighted in NAB's agreements with business customers as a key term of those contracts.⁵⁷ In the case of the Smiths, a key reason for them refinancing from Suncorp-Metway to NAB in 2008 was their desire to change from the default interest terms offered by Suncorp-Metway to the default interest terms offered by NAB.⁵⁸
50. Third, NAB proposed and attended a farm debt mediation with the Smiths in September 2013, at which it in fact reached an agreement with them to waive all future default interest and \$50,000 of accrued default interest, so long as the Smiths complied with the relevant Forbearance Deed (as described in paragraph 20 above). The Smiths were represented at that farm debt mediation by both a Legal Aid solicitor and Rural Financial Counsellor. In NAB's submission, this mediation and agreement is important context to any assessment of whether NAB engaged in conduct falling below community standards in its application of default interest to the Smiths after that point. This is so in circumstances where the mediation process was certified by the mediator to have been conducted in good faith; the Smiths subsequently did not comply with a Forbearance Deed which they had agreed to on advice; and the Smiths are now non-committal about attending a further mediation to seek a resolution with NAB.
51. Fourth, since the Smiths' non-compliance, it has been difficult for the bank to reach a new agreement with the Smiths. NAB accepts that there were legitimate reasons for the Smiths' failure to meet their obligations under the Forbearance Deed, including the ongoing drought at the Hughenden Property which was the property they had chosen to sell. It also understands why a person under the stresses faced by the Smiths might disengage from corresponding with their bank. However, as a practical reality, when a customer in the position of the Smiths disengages with the bank or is unresponsive to communications, it is difficult for the bank to reach any resolution with them.
52. Without descending into the detail of all of the correspondence between NAB and the Smiths and their various advisors in the period from May 2014 onwards for the purposes of these submissions, in NAB's view a significant part of that correspondence was characterised by the

⁵⁷ See for example the agreements with the Smiths referred to at McNaughton Statement 2 at [68].

⁵⁸ See for example McNaughton Statement 2, tab 21, NAB.005.512.0115.

Smiths not providing information sought by NAB or not responding to correspondence from NAB, and the Smiths otherwise not engaging substantively with NAB about the situation that they were facing at particular points in time. This included:

- a) several requests by NAB for information about the status of marketing one of their properties for sale, which was not provided (see paragraphs 22 and 23 above);
 - b) several requests by NAB for National Livestock Identification Scheme database information in relation to the movement of the Smiths' cattle, which was not provided (see paragraph 24 above);⁵⁹
 - c) the Smiths cancelling a scheduled visit by the National Consulting Group to visit the properties and inspect the cattle and pastures as part of a potential strategy being explored and agreed with their advisor at the time, and National Consulting Group not being able to reschedule a meeting with them (see paragraph 27 above);
 - d) signs being put up at the Smiths' Hughenden Property in about May 2016 stating 'Entry by Invitation Only or Trespass Applies' and citing a number of legal authorities relating to trespass (see paragraph 27 above);⁶⁰ and
 - e) indications from one of the Smiths' advisors that it was no longer acting for them including because they would not comply with placing a property on the market, were not contactable at critical junctures and ignored correspondence (see paragraph 28 above).⁶¹
53. Fifth, the practical difficulty in engaging with the Smiths was heightened by the frequent changes in their advisors and the different approach each advisor adopted to its engagement with NAB. In the period since the farm debt mediation in September 2013, the variety of persons who have acted on behalf of the Smiths includes as follows: John Swain (Rural Financial Counsellor), Rachel Bock (Rural Financial Counsellor), Neil Fleming (ODTTA Enterprises, Business & Finance Consultants), John Carey (accountant), Daniel Simonfi (DJ Partners) and Rodney Culleton.
54. Sixth, a key reason why default interest has accrued for this length of time is that NAB has never sought to take the step of last resort and commence enforcement action against the Smiths, despite the Smiths' non-compliance with the Forbearance Deed (which would have otherwise provided the Smiths with relief from that default interest). Rather, NAB has allowed the Smiths to remain on both their properties since the file was first referred to SBS in 2012. Further, when the Charters Towers Regional Council was proceeding to enforcement against

⁵⁹ NAB's entitlement to this information arose, among other things, from clause 7(d) of the Forbearance Deed and clause 12.5 of the Stock Mortgage (see McNaughton Statement 2, tab 33, NAB.148.018.8915).

⁶⁰ See also McNaughton Statement 2, tabs 116 to 118, NAB.148.014.1701, NAB.148.014.1705 and NAB.148.014.1706.

⁶¹ See also McNaughton Statement 2, tab 120, NAB.148.015.5509.

the Smiths in 2013, NAB provided funds for the Smiths to pay the Council's rates to avoid enforcement (see paragraphs 15 and 18 above). Similarly, when the Smiths were in the midst of bankruptcy proceedings commenced by the Australian Taxation Office, NAB provided funds to the Smiths for feed for their cattle (see paragraphs 25 and 26 above).

55. Seventh, NAB continues to try to seek a resolution with the Smiths. NAB again proposed mediation in January 2018. To date, the Smiths have yet to accept or decline that proposal, and Mrs Smith has indicated in her evidence that they remain non-committal. If mediation occurs, NAB considers that a mediated outcome should involve discussing relief from past and future default interest for the Smiths to enable the Smiths to refinance, and for the Smiths to remain in possession of one of their properties and to have cattle from which to earn an income. In this context, it is significant that Mrs Smith herself acknowledged that the Smiths have a substantial debt to the bank and would like to sell one of their properties to clear their debt, and refinance if required.⁶²
56. Eighth, and for clarity, NAB does not accept the apparent characterisation in the proposed finding that NAB has charged default interest for the period of time alleged in circumstances where the Smiths' business was affected by flood. NAB's understanding of Mrs Smith's evidence is that there was a flood at the Pentland Property in early 2012, and the primary impact of that flood was a temporary inability to bring cattle to market.⁶³ Following NAB becoming aware of the impact of this event on the Smiths' ability to make their repayments, in August 2012 NAB assisted the Smiths by providing an increase in their overdraft limit, in circumstances where a sale of cattle was imminent (see paragraphs 9 and 44 above). There was then a period of some months before the Smiths were again in default of their overdraft limit from 1 November 2012, and it was not until 28 March 2013 when default interest commenced accruing on their \$3.1 million loan.⁶⁴
57. Ultimately, NAB accepts that the Smiths' case study raises difficult issues about the circumstances in which default interest might be waived for agricultural customers suffering long term adverse climatic conditions. Indeed, as Mr McNaughton observed, the Smiths' file is a difficult file, even by the standards of NAB's SBS team. It is a case where NAB considers it is unlikely that the Smiths' loans could be rehabilitated and repatriated to their relationship banker, but where NAB also has not taken and does not presently intend to take the step of enforcement given, *inter alia*, the extended period of drought facing the Smiths' properties.⁶⁵
58. NAB also accepts that, with the benefit of hindsight, it could potentially have done more in its communications with the Smiths in the period after their default under the Forbearance Deed, including by more squarely raising the issue of accrual of default interest with the Smiths and

⁶² Smith XXN at T3565.7-10.

⁶³ Smith XXN at T3547.9-25.

⁶⁴ McNaughton statement at [149], [152].

⁶⁵ McNaughton Statement 2 at [171]-[172].

their advisors following their non-compliance with the Forbearance Deed. However, in all the circumstances outlined above, NAB does not accept that it engaged in conduct falling below community standards and expectations with respect to the application of default interest to the Smiths.

Proposed finding 3 – In the light of Mr McNaughton’s evidence as to the purpose for which default interest is charged, it is open to the Commissioner to conclude that ‘NABs conduct in charging default interest to the Smiths over such a long period was the product of a culture by which default interest was used as a strategic tool to place pressure on borrowers in default. That such a culture exists is reinforced by Mr McNaughton’s evidence that he would expect default interest to be waived at a future farm debt mediation and that his experience has been that all or a large element of default interest is waived by that process. However, the application of default interest in the lead-up to such a mediation only serves to weaken the position of the farmers participating in those mediations and lessen their bargaining position’.

59. NAB does not consider that it is open to the Commission to find that the alleged culture exists.
60. First, the proposed finding is premised on an assumption that there was no legitimate basis for NAB to charge default interest other than as a strategic tool to place pressure on borrowers. However, the highest the evidence goes is the following exchange between Counsel Assisting and Mr McNaughton:

Do you know whether or not there is any relationship between cost of capital as a consequence of impairment and the – and a bank’s decision to charge default interest?---No, I’m sorry, I don’t know the answer to that.

All right. So in your understanding of default interest, just moving away from impairment and cost of capital and moving to the more vanilla question of default interest, why do banks charge default interest?---I think in Australia it has become customary for banks to include default interest in the contract and as an incentive to comply with the terms.⁶⁶

61. It is evident from this exchange that Mr McNaughton simply does not know the relationship, if any, between the cost of capital as a consequence of impairment and the application of default interest. Mr McNaughton’s evidence is not surprising - it is not within Mr McNaughton’s responsibility within NAB for managing a portfolio of stressed or defaulted business loans, and it is not a topic on which NAB was asked to provide evidence in the questions to which Mr McNaughton’s written statement responded.⁶⁷ The inclusion of contractual terms regarding default interest is a matter for those within the bank who formulate such terms. Mr McNaughton is not such a person. The persons who formulate such terms do so by reference to a range of

⁶⁶ McNaughton XXN at T3591.27-35.

⁶⁷ McNaughton Statement 2 at [11].

considerations, none of which were the subject of evidence. In these circumstances, NAB submits that there is no proper basis for the Commission to make findings in the terms proposed.

62. Second, in response to Counsel Assisting's questions as to why banks generally charge default interest, Mr McNaughton, as a person who does not have responsibility for the formulation of terms regarding default interest within NAB, has made the obvious points that it is customary for banks in Australia to charge default interest, and that if higher default interest rates could apply to a customer if they are in default, that will act as an incentive to a customer not to default on their obligations. His evidence rises no higher than reflecting, as already stated at paragraph 48 above, that default interest is a standard, customary and entirely legitimate feature of business lending contracts.
63. Mr McNaughton's evidence as to the purpose for which default interest is charged does not form a basis for the Commission to conclude that NAB has a culture by which default interest is used as a strategic tool to place pressure on borrowers in default. Mr McNaughton made no reference to any cultural issues within NAB concerning default interest, either in his written statement or in cross-examination. Further, at no stage was it put to Mr McNaughton in cross-examination that there was some cultural issue within NAB regarding the use of default interest as a strategic tool to place pressure on borrowers in default, or any question to a similar effect.
64. Third, the proposed finding appears to suggest that NAB has a culture of deliberately deciding to charge default interest for the purpose of placing pressure on borrowers at mediation. There is no evidence whatsoever before the Commission to this effect. NAB does not make a strategic decision, once a business customer (agricultural or otherwise) is in default, to then apply default interest to that customer. Default interest is instead applied to a customer in default as a matter of course (by automatic process)⁶⁸, in accordance with the terms of the contract with that customer. There is no separate and strategic decision to charge default interest to a business customer to place pressure on them. To the contrary, as Mr McNaughton's evidence reflects, NAB gives consideration as to whether it might *waive* its entitlement to default interest, having regard to the particular circumstances of that customer.
65. Fourth, NAB recognises that there may be situations in which an agricultural customer should have some or all of their default interest waived. Whether that should occur will necessarily be specific to the circumstances of a particular customer, which may include the extent to which the customer's default may be attributed to financial difficulty arising from climatic, seasonal or economic factors. In appropriate circumstances, NAB's SBS team is willing to discuss waiving default interest for a customer in such a position⁶⁹ (among other options to assist the customer⁷⁰). In NAB's view, such a practice in fact points to NAB *not* having a culture of using

⁶⁸ McNaughton XXN at T3587.24.

⁶⁹ McNaughton Statement 2 at [165].

⁷⁰ McNaughton Statement 2 at [52].

default interest as a strategic tool to exert pressure.

66. Fifth, in order for NAB to assess whether the circumstances of a particular customer are such that default interest ought to be waived, NAB will seek to obtain a proper understanding of a customer's position. Often, prior to farm debt mediation, NAB will not have that proper understanding of the customer's position, particularly where the customer has not provided relevant information such as financial statements and accurate cash flow budgets. The fact that NAB might wait to discuss waiver of default interest until it has a more informed understanding of the customer's position at a farm debt mediation when all parties are together does not, in NAB's submission, speak to a culture of using default interest as a strategic tool to create pressure or other conduct falling short of community standards or expectations.
67. Sixth, the evidence before the Commission in the case study of the Smiths was that NAB was proactively pushing for the mediation to be held at the earliest possible time because the Smiths were incurring interest at default rates (see paragraph 17 above). That is not conduct consistent with the use of the accrual of default interest as a strategy to maximise pressure on borrowers. It suggests, instead, a culture and practice of trying to meet with customers as soon as practicable to limit the accrual of default interest.
68. Seventh, in NAB's submission, Mr McNaughton's evidence that he would expect default interest to be waived at a future farm debt mediation does not provide any support for the existence of the culture alleged by the Commission. In NAB's submission, the opposite conclusion ought to be drawn: the evidence shows that NAB is ready and willing to waive its contractual entitlements to a customer in the position of the Smiths at mediation, and does not propose to use its entitlement to default interest as a device to apply pressure.
69. Eighth, Mr McNaughton's evidence that, in the particular case of the Smiths, the application of default interest has been to the disadvantage of both the Smiths and the bank and has not assisted the bank to rehabilitate the loan to the performing book, also suggests that default interest is not used by NAB as a strategic tool to place pressure on borrowers in default.⁷¹ Such acknowledgements are consistent with Mr McNaughton's evidence that SBS's ultimate objective is to rehabilitate loans to the performing book.⁷²
70. In NAB's view, the evidence suggests that NAB in fact has a culture and practice of seeking to rehabilitate loans and to avoid enforcement action wherever possible, and recognising that there will be particular circumstances where its contractual entitlements may act as a disadvantage to achieving that objective and ought to be waived.

Opportunity to be heard with respect to any additional adverse findings

71. If the Commission intends to make any adverse findings against NAB or any of its employees in

⁷¹ McNaughton XXN at T3588.40-44; T3586.38-40.

⁷² McNaughton Statement 2 at [52].

connection with this case study, other than those identified by Senior Counsel Assisting in her closing submissions, NAB seeks notice of the same and an opportunity to be heard in relation to them.

13 July 2018

W A Harris

D F C Thomas

H Mann

T Kane