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## TRANSCRIPT OF PROCEEDINGS

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O/N H-909731

**THE HONOURABLE K. HAYNE AC QC, Commissioner**

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

**BRISBANE**

**9.30 AM, FRIDAY, 29 JUNE 2018**

**Continued from 28.6.18**

**DAY 34**

**MS R. ORR QC appears with MR M. COSTELLO as Counsel Assisting with MR M. HOSKING and MS S. ZELEZNIKOW**

**MR C. SCERRI QC appears for Bankwest and CBA**

**MR D. THOMAS appears with MR T. KANE for NAB**

THE COMMISSIONER: Ms Orr.

MS ORR: Commissioner, before I proceed with the cross-examination of Ms Taylor, there are two preliminary issues. The first is that I wanted to say something  
5 about some questions that I asked of Ms Taylor yesterday afternoon. I asked Ms Taylor about the circumstances in which she came to exhibit the documents that are exhibits 28A and 28B to her statement, and Ms Taylor accepted that those documents were not exhibited to her original statement and that they were added when she re-swore her statement on Sunday. I then asked Ms Taylor whether she exhibited those  
10 documents as a result of having received a notice to produce from the Commission, and Ms Taylor said that she wasn't aware that there had been a notice, and I indicated that I could tender the notice if issue was taken.

Now, there was a notice to produce seeking those documents issued by the  
15 Commission, but we now understand that the notice was served on Bankwest lawyers shortly after they had provided a draft version of Ms Taylor's statement that exhibited those additional two documents, and we want to make that clear.

THE COMMISSIONER: Yes, thank you.  
20

MS ORR: The second preliminary issue arises from another notice to produce that was issued by the Commission to Bankwest on 8 June. That notice to produce was returnable on 14 June. Overnight, we have been provided with nine documents that Bankwest accepts ought to have been produced under that notice to produce. We  
25 have reviewed those documents this morning and I wish to ask Ms Taylor questions about those documents. The documents need to be redacted to remove customer names and the name of the bank manager, who has been the subject of some evidence, and I understand from Mr Scerri that they are in the process of being redacted so that they can be uploaded on to the system. They are not yet in redacted  
30 form on the system. So I think, unfortunately, it will be necessary for us to take a short adjournment to allow them to be uploaded in a useable form before I ask Ms Taylor questions about them.

THE COMMISSIONER: How long do you need?  
35

MR SCERRI: Commissioner, I should first of all apologise for that. We received them yesterday from the business.

THE COMMISSIONER: When?  
40

MR SCERRI: Yesterday – sometime before 10.30 pm. I saw them - - -

THE COMMISSIONER: When?

45 MR SCERRI: 10.30 pm yesterday, sir.

THE COMMISSIONER: You said shortly before, did you?

MR SCERRI: I was told - - -

5 THE COMMISSIONER: Sometime before, you said. My question was when did you - - -

MR SCERRI: I can find that out.

10 THE COMMISSIONER: Did your solicitors receive them.

MR SCERRI: I can find that out.

THE COMMISSIONER: Yes.

15

MR SCERRI: I was told 10.30 pm. I saw them this morning at about – just after 5 am, when Mr McInness had sent them to solicitors instructing, but I will find out when they received them, your Honour – Commissioner. Mr McInness has gone out to try and find out where they are. I know people have been redacting them this morning, and we do regret that this has happened.

20

THE COMMISSIONER: How long do you need to redact them?

MR SCERRI: Can I seek instructions, Commissioner.

25

THE COMMISSIONER: Yes.

MR SCERRI: Commissioner, I'm instructed that they will be here in 15 minutes in redacted form.

30

THE COMMISSIONER: If I come back at 9.50, will that be sufficient time?

MR SCERRI: Yes, sir.

35 THE COMMISSIONER: Well, I will adjourn until 9.50.

**ADJOURNED**

**[9.34 am]**

40

**RESUMED**

**[9.51 am]**

THE COMMISSIONER: Yes, Mr Scerri.

45

MR SCERRI: Commissioner, I've sought instructions about the documents. I'm told that the person who located them in Perth yesterday was the person who was

looking for the document about the culture review. Do you recall that evidence yesterday? Secondly, I'm told that they were provided to the solicitors in Brisbane at 4 pm, and that the first task that was undertaken was to check whether they had already been produced.

5

THE COMMISSIONER: You say they were provided to the solicitors in Brisbane at 4 pm.

MR SCERRI: Yes, sir.

10

THE COMMISSIONER: By that do you mean that no other person in those instructing you had access to them before that time?

MR SCERRI: That's my understanding.

15

THE COMMISSIONER: A very careful answer, Mr Scerri, and I don't want there to be some misunderstanding. When did your solicitors receive these documents?

MR SCERRI: My instructions are 4 pm, but may I check that, sir?

20

THE COMMISSIONER: Yes, do.

MR SCERRI: That is correct, sir. They're our instructions.

25

THE COMMISSIONER: Yes. And the documents are – or the fact that there are extra documents are – is told to the Commission at 10.51 pm. Is that right, that day?

MR SCERRI: I thought it was early this morning, sir. 10.51 pm.

30

THE COMMISSIONER: And redacted reversions were then made available at 12.24 am; is that right?

MR SCERRI: Yes. Redacted for privilege, but not redaction for the names.

35

THE COMMISSIONER: I understand that.

MR SCERRI: Yes. That's the – that's the difference, sir. And that's what we've been waiting for this morning.

40

THE COMMISSIONER: Just to be certain. You say that your solicitors first had these documents at 4 pm yesterday.

MR SCERRI: They are absolutely our instructions sir, yes.

45

THE COMMISSIONER: Yes, I understand that. Very well, I will consider what follows from this course of events. Do go on, Ms Orr.

<CROSS-EXAMINATION BY MS ORR

5

MS ORR: Thank you, Commissioner.

10 Now, could we start, Ms Taylor – I want to show you the notice to produce under which these documents were sought. That is RCD.0002.0001.4385. Now, I understand, Ms Taylor, you've been shown the nine documents this morning; is that right?---I have, yes.

15 Yes. Now, this is the notice to produce served by the Commission on – CBA on the 14<sup>th</sup> – I'm sorry, I will take you to the third page, 4387. Issued by the Commissioner on 8 June. And if we go back to 4385, returnable on 14 June; do you see that?---Yes, I do.

20 And it required production of a number of categories of documents. Could I ask you to look at subparagraph (c) at the bottom of the page in relation to paragraph 22 of the statement, and then could we go over to the following page, 4386. The notice sought:

25 *Any documents recording the circumstances in which the bank manager left CBA.*

?---Yes.

30 And you accept that there are documents amongst the nine that meet that description. They are documents recording the circumstances in which the bank manager left CBA?---Yes.

Thank you. And we see down the page category (l):

35 *Any documents recording any complaint made by any CBA customer in relation to the bank manager.*

40 Do you accept that there are documents amongst the nine that meet that description?---Yes.

And category (m):

45 *Any documents recording any reports or investigations by or for CBA in relation to the bank manager.*

Do you accept that the documents include documents that meet that description?---Yes.

So the nine documents ought to have been produced under this notice to produce?---Yes.

I tender the notice to produce, Commissioner.

5

THE COMMISSIONER: Exhibit 4.102, notice to produce number 653, RCD.0002.0001.4385.

10 **EXHIBIT #4.102 NOTICE TO PRODUCE NUMBER 653  
(RCD.0002.0001.4385)**

15 MS ORR: Now, the documents that were found yesterday include the resignation letter of the bank manager, is that right, Ms Taylor?---Yes, it is.

Now, if we could have that brought up. CBA.4000.0110.0026. This is the bank manager's resignation letter?---Yes.

20 And we see in the second paragraph down the bank manager tells Bankwest:

*My decision to resign from Bankwest has not been made lightly, but has been greatly influenced by a number of factors which you and I discussed. These factors are –*

25

and then the first one is –

*at the conference in last November, you mentioned to us all that there was going to be a significant change within our business around early February. This statement provided me with a great deal of uncertainty around my future and it simply made me nervous. As you are aware, I commenced looking for opportunities outside of Bankwest at that point.*

30

35 Now, what was the significant change within the business around early February of this year, Ms Taylor?---I've had limited time, obviously, to look into this, but from my understanding this will relate to the – the strategy that I talked about yesterday in relation to the exit of the east coast agri market and moving the customers to different locations.

40 Now, what would have given the bank manager – what would have created uncertainty for him around his future flowing from that change?---I would assume the – he was referring to the closure of the Toowoomba business centre.

45 Yes, I see. And that's the second – related to the second matter that he raises in this letter. He says:

*I am not fully in agreement with the new R & R strategy.*

Is that rural and regional?---It is, yes.

Continuing:

5            *I am struggling with why so many offices and ones such as Bundaberg and  
Dubbo (centre of New South Wales with both Landmark and Elders having  
their state offices based there) had to close. I am also concerned with the  
actual level of staffing within Toowoomba office. When I joined Bankwest  
10            Toowoomba there was seven staff in the office and now there will be three. I  
can't see how three staff are going to be able to process the amount of work  
required for this office to be successful going forward.*

So at that point it seems that the Toowoomba office was to remain open?---Yes, it  
would appear so.

15

But other bank – sorry, other Bankwest branches had been closed?---Business  
centres, not necessarily branches.

20            Yes. Business centres, thank you. And the final factor that the bank manager refers  
to relates to a particular person who was going to be – going to be the bank  
manager's direct manager, and he had been told that he was no longer going to be his  
manager; is that right?---Yes, that is.

25            All right. So these were the matters that the bank manager raised upon his  
resignation from Bankwest?---Yes.

I tender that letter, Commissioner.

30            THE COMMISSIONER: Exhibit 4.103, manager's resignation letter,  
CBA.4000.0110.0026.

35            **EXHIBIT #4.103 , MANAGER'S RESIGNATION LETTER  
(CBA.4000.0110.0026)**

35

MS ORR: Now, I asked you questions yesterday, Ms Taylor, about the conduct  
issues that were identified by Bankwest prior to and around the time of the bank  
manager's departure - - -?---Yes.

40

- - - from Bankwest. Now, are you able to tell us how those issues were detected by  
Bankwest?---So from my understanding the issues were detected from a phone call  
from the – one of the customers in relation to the transfer of funds that I mentioned  
yesterday. That customer was phoning to ascertain where their interest payment was  
45            on their term deposit.

I see. And could I show you CBA.4000.0110.0241. And if I could ask you to direct your attention to the email that commences at the bottom of that page. And if we could have the subsequent page on the screen at the same time. The date of this email, I assume, is in the American form. I assume that this is 2 April rather than 4  
5 February, given the content of this email. Is that a fair assumption, Ms Taylor?---I – given I’ve just seen it this morning, I don’t know, but it would be a fair assumption.

Well, these relate - - -

10 THE COMMISSIONER: The email is given as Tuesday, 03 April?---Yes.

MS ORR: So the 2 April email is from Mark Ellul. Is that his name? Mark Ellul, to a number of people within Bankwest on 2 April, and it relates to the Toowoomba office, Queensland Rural and Regional. And we see there that Mr Ellul refers to a  
15 teleconference that he has had with the recipients of that email, and he says:

*A number of significant issues have arisen within the Toowoomba portfolio of the final week of the bank manager’s employment last week and since. These have been highlighted by gaining access to the bank manager’s mobile phone and team member feedback.*  
20

So having read this email, Ms Taylor, does it appear to you that members of Bankwest took control of the bank manager’s mobile phone?---So my understanding is he would have left and, when a banker leaves, they hand over their mobile phone  
25 for continuity of relationship. So if customers do call on that number, they will – they would have retained for that purpose. I believe the relationship manager was taking the calls on that phone.

So having obtained access to the bank manager’s mobile phone, a number of issues with his conduct were identified from material on the phone?---No. So I think this  
30 relates to the call from the customer in relation to the transfer of moneys, and the interest in the term deposit came in on his phone.

Well, what – how do we understand then – what do we understand the sentence to  
35 mean:

*These have been highlighted by gaining access to the bank manager’s phone.*

?---So access meaning the – the phone was now in the hands of the relationship  
40 manager, no longer the banker. So she was taking the calls from the customers.

So the – what do you understand from this was highlighted by gaining access to the phone?---I’m sorry, I don’t understand what you’re asking.

45 I’m just asking for your understanding of what that sentence means:

*These have been highlighted –*

“These” being the issues I’m going to take you to?---Yes.

The conduct issues that are identified below, they:

5           *...have been highlighted by gaining access to the bank manager’s mobile phone.*

?---So my understanding is that by – the banker would normally, obviously, answer their own phone and take the calls.

10

Yes?---And so therefore any – anything that was happening on those calls, no one else would be privy to, because the relationship manager had the phone, the information was uncovered in the discussion with the customers, and that’s what I understand that to mean.

15

So do you understand this to be referring to conversations that the person who took over the phone had with customers - - -?---Yes.

- - - subsequent to his departure?---Yes.

20

From the bank manager’s departure?---Yes.

Okay. I understand. And then we see the issues that are identified that have been highlighted by that access and from team member feedback. Now, some of these I asked you questions about yesterday, others I did not, because they were not clear on the documents that we had been provided with at that stage. Number 4 relates to a:

25

*Potential conflict of interest in a significant number of transactions being referred by –*

30

a relative of the bank manager; is that right?---Yes, it does say that, yes. Yes.

Yes. And do you see at number 5 that there was a:

35

*Statement which was still to be confirmed that the bank manager and his relative owned 600 head of cattle which were agisted on a customer’s property.*

?---Yes.

40

And you see the email records:

*These are one of the customers that required an urgent approval and settlement last week. Potential conflict of interest!*

45

?---Yes.

So that was identified as a further issue with the bank manager’s conduct?---Yes.

A significant conduct issue; do you agree?---Yes, I do.

And then number 6:

5            *It appears that the bank manager prepared a significant proportion of cash flow budgets and SOPs on behalf of –*

that customer?---Yes.

10          Continuing:

*...and that leaves the question open in relation to the customer's ability to prepare those budgets and the reliability of year in year out and actual stock numbers.*

15

?---Yes.

And do we see further down after – there's a detailed examination of some of the other conduct issues that we discussed yesterday, including the term deposit transfer and the verbal approvals that had been given by the bank manager. You see underneath that, the paragraph:

20

*Whilst we should be able to minimise any fallout on most of the above groups –*

25          the above groups are his customers; is that right?---Yes. I – from this I would say, yes.

Continuing:

30            *My concerns centre on how many more potential issues reside within the portfolio. Without an in-depth review it is difficult to estimate.*

?---Yes.

35          And there's a series of action items, one of which is that:

*Mr Ellul is to take control of the mobile phone and handle all customer complaints and dialogue with the above listed connections.*

40          ?---Yes.

Now, I tender that document, Commissioner.

45          THE COMMISSIONER: Exhibit 4.104, emails between Ellul, Watson and others at Bankwest, 2 to 3 April 2012, CBA.4000.0110.0241. Exhibit 4.104.

**EXHIBIT #4.104 EMAILS BETWEEN ELLUL, WATSON AND OTHERS AT BANKWEST, DATED 2 TO 3 APRIL 2012 (CBA.4000.0110.0241)**

5 MS ORR: I just want to be clear that your answers today – I want to be clear on when Bankwest learnt of this misconduct. Some of this misconduct was conduct that Bankwest was aware of before the resignation of the bank manager, wasn't it?---So my understanding in reviewing the files is that the trigger for the discovery of the misconduct was at the time that that call was intercepted.

10 And are you aware that in the lead-up – in the week prior to the bank manager's resignation, Bankwest required him to finish up immediately and removed all of his system access prior to the date on which he was due to resign?---No, I'm not. No.

15 Could I show you a document that tells us that. CBA.0002.2114.0587. I will just – I will let you look at the first page - - -?---Yes.

- - - so that you can see that it's an email chain, and then I will direct you to the relevant page, which is 0590. And do you see under Action in the middle of the page, BDM – that's business development manager – and it's this bank manager who had resigned from the bank and was due to finish 30 March 2012:

20 *...was finished up immediately and all system access removed. Risk events were input to RiskInSite.*

25 ?---Yes.

30 So do you agree these issues were becoming apparent to Bankwest before the date of the manager's resignation?---No. So when you resign you give four weeks' notice - - -

I see?--- - - - so he would have been on his notice period - - -

35 I see?--- - - - at the time that this was discovered.

You are referring to the date when he tendered his resignation?---Tendered his resignation and then four weeks later he would leave, and so they've uncovered and from this it looks like exited him prior to his notice period being worked.

40 Yes. So in that notice period these issues were emerging?---Yes.

Yes, I'm sorry. I understand. Thank you. That document has already been tendered yesterday, Commissioner.

45 THE COMMISSIONER: Thank you.

MS ORR: Now, could I ask you to look at another of the documents provided to us overnight. CBA.4000.0110.0223. Now, this is 2 April, so the same date as the email that I took you to before that referred to taking over access of the bank manager's mobile phone. This is an email from Belinda King, who took over from the bank manager. You recall the evidence that she became the Ruddys bank manager after the departure of the bank manager?---So she was always on that portfolio.

Yes?---So she would have dealt with all of these customers but, yes, she took over on his departure, yes.

Yes. And his departure was a few days prior to this email. And we see that she's referring to a 30 minute discussion which you will have seen, from the unredacted version of this document, was a discussion with a customer?---Yes.

A customer who was not Mr Ruddy?---Yes.

And we see that she says:

*I have attached my notes that are brief, but outline the points that that other customer raised. I must say he was very reasonable and more than willing to work with us on a resolution as he wants a win-win situation. I didn't comment on anything and arrange for [REDACTED and [REDACTED] to be contacted tomorrow by 4 pm.*

So Ms - - -

MR SCERRI: That's redacted on the screen.

MS ORR: I'm sorry, the - I'm sorry, I apologise. I mentioned two names that ought to have been redacted there.

THE COMMISSIONER: Yes.

MS ORR: Sorry. So we see she is not commenting on anything in the conversation with this customer. Do we interpret that as she is not commenting on the circumstances in which the bank manager has left Bankwest?---I took it she is not commenting on anything in relation to the customer issue, as she hasn't had a chance to look at it fully.

I see. And we see a description of the customer issue in the third paragraph:

*This customer's main issue was around the valuations as the bank manager had apparently valued the property at 2.1 million. He would agree to having the property valued, I think, and also advised he would be prepared to reduce the purchase price to ensure Bankwest can complete the finance.*

So another customer dealing with valuation issues caused by the bank manager?---Yes

I tender that document, Commissioner.

5

THE COMMISSIONER: Exhibit 4.105, email from King, Bankwest 2 April '12, CBA.4000.0110.0223.

10 **EXHIBIT #4.105 EMAIL FROM KING, BANKWEST DATED 02/04/2012 (CBA.4000.0110.0223)**

15 MS ORR: And we can see from the documents we've received overnight, Ms Taylor, that the valuation issues in connection with this bank manager extended beyond inflated valuations: they extended to circumstances where there were incomplete valuations or no valuations at all undertaken to support finance applications?---Yes.

20 Thank you. And we also see issues that are apparent from the documents produced overnight in relation to irregulars and dishonours; do you recall that?---Yes.

Could I ask you to look at CBA.4000.0110.0583. Do you see under Irregulars and Dishonours:

25

*The ongoing review of the Toowoomba portfolio has identified a number of customer groups that have had significant irregular and/or dishonour history and are now being transferred direct from good book to CAM.*

30 CAM?---It's the asset management ..... GCS.

And these include the following groups – and the customer names are redacted, but they are all customers of the bank manager?---Yes.

35 And the principle systems that this document records were in place to assist identifying these behavioural issues were Genesis and the monthly RPR and irregular reports produced by BWB risk reporting?---Yes.

40 So those are internal systems designed to detect these sorts of problems?---That's right, yes.

Continuing:

45 *Review of the RPR reports back to September 2011 reveals that the irregular and dishonour behaviours were not appropriately captured which reduced its effectiveness as an early warning system. Only once (January 2012) was any of these accounts listed for dishonour behaviour (it should appear after five*

*dishonours) and only once (December 2011) was one of these accounts listed for irregular behaviour (should appear after 30 days irregular).*

You see that?---Yes, I do.

5

And:

*Initial investigations indicate that the bank manager was using the behaviour triggers function in Genesis to reset the dishonours to zero, thereby resulting in non-escalation on the RPR system.*

10

?---Yes.

So that's a further form of misconduct on the part of the bank manager that was identified by Bankwest?---Yes.

15

Thank you. I tender that document.

THE COMMISSIONER: Have we got a date for it, Ms Orr?

20

MS ORR: No. Unfortunately, I don't, Commissioner. It is an undated document.

THE COMMISSIONER: Memorandum Toowoomba business centre process issues CBA.4000.0110.0583, exhibit 4.106.

25

**EXHIBIT #4.106 MEMORANDUM TOOWOOMBA BUSINESS CENTRE PROCESS ISSUES (CBA.4000.0110.0583)**

30

MS ORR: And the final document I want to take you to, Ms Taylor, is CBA.0002.2115.3931. The final of the documents provided overnight. So this is a briefing note described as:

*Briefing with Jenny prior to meeting with Harrison Young.*

35

?---Yes.

And it's undated, but we can see from dates that appear in the document that it must be dated after 23 April 2012 and before 3 May 2012?---I had a very brief look this morning, so - - -

40

Yes?---Yes.

Who is Harrison Young, Ms Taylor?---I have no idea.

45

Well, Harrison Young, it appears to us, was on the CBA board at this time. Would that be right?---Potentially. As I say, I only saw the document this morning.

5 THE COMMISSIONER: I can't hear you, I'm terribly sorry, Ms Taylor. You will have to speak up?---I'm sorry, I only saw the document this – this is the first, you know, time I have seen it. I have no context as to what this meeting is or who the parties to the meeting are. If you could flick through a few pages, I can have a look and try and figure that out.

10 MS ORR: Yes, of course. So if we go to 3932. We see there:

*Rural and regional banking, Toowoomba business centre update, as at 23 April 2012.*

15 ?---Yes.

And do you see the reference to the operational risk incidents currently under review that we've been discussing?---Yes.

20 And do you see the reference to, "The most serious risk incidents"?---Yes.

Continuing:

25 *Issuing of two unconditional letters of finance approval when applications had not been approved by business credit and arranging (and allegedly advising) an elderly customer to prepay a term deposit of 350,000 with the funds then directed to an unrelated customer.*

30 ?---Yes.

So these are the risk incidents in relation to the bank manager that we've been discussing?---They were risk insights – risk incidents that were put into RiskInSite, our risk management system.

35 Yes. So certainly not the totality of the - - -?---No.

Of the incidents in relation to the bank manager?---No.

40 And then we see a reference to initial investigation, and I asked you some questions about that investigation yesterday?---Yes.

And it identified a total of 18 matters that required attention?---Yes.

45 And we see there some of the matters that I've mentioned to you this morning:

*Incomplete or no valuations undertaken to support finance application.*

?---Yes.

And then I will show you the following page, 3933, which gives a summary of the status in relation to particular customers who do not include the Ruddys?---Yes.

5

And the final page of the document, just so that you've seen the entirety of the document, 3934, deals with the scope for the Queensland targeted review?---Yes.

10 So having looked at the document now, what I want to put to you is that this is a briefing for the member – a member of the CBA board about the conduct of this bank manager and the investigation into the Toowoomba portfolio more generally that flowed from the conduct of the bank manager?---Is – is it possible to see the other pages that don't relate to Toowoomba, so that I - - -

15 There are no other pages?---There aren't any.

20 It's a four page document and I have now showed you each of those pages?---I'm not aware that this would have been escalated – I am not aware that it would have been escalated to the board, and I can't tell from the title of the pack, given it's a “meeting with Jenny”, that wouldn't be a normal way of documenting something that was going to the board.

25 Well, let's look back at that first page again, 3931, to see the agenda for the meeting with this member of the CBA board. It includes APRA accreditation status. Someone is going to report to him on that. We see two individuals are going to report to him on the Queensland targeted review and Toowoomba update, which is what the document deals with. Do you see that?---Yes, I do, yes.

30 And someone else is going to report to him about Four Corners CAM. Do you know what that's a reference to?---No, I don't.

Well, around this time in April 2012, Four Corners aired an episode relating to the conduct of Bankwest. Do you recall that?---I didn't work at Bankwest at the time.

35 I see. So you're not familiar with the piece on Bankwest about the takeover that was called Happy Banking that was aired at that time?---No.

40 All right. But do you accept from this document, Ms Taylor, the matters that we have been discussing about the conduct of this bank manager and the Toowoomba portfolio more generally were escalated to Mr Young, a member of the CBA board?---I can't make that assessment from this document. As I say, I have never seen a document escalated in that way to the board. To have a title that says “briefing with Jenny prior to meeting with Harrison Young” would indicate to me that this is a meeting with these people with Jenny, not with Harrison Young.

45

To prepare for a meeting with a member of the CBA board?---Potentially.

Well, that's what it says, isn't it?---Yes, it is, yes.

Thank you. I tender that document, Commissioner.

5 THE COMMISSIONER: Briefing note Bankwest, CBA.0002.2115.3931, exhibit 4.107.

10 **EXHIBIT #4.107 BRIEFING NOTE BANKWEST (CBA.0002.2115.3931)**

MS ORR: Now, I said wrongly before, Commissioner, that I had tendered the previous document when I had not. So could I please tender CBA.0002.2114.0587, which is an email chain entitled Status and Update on Toowoomba dated 4 April 15 2012.

THE COMMISSIONER: Email chain Status and Update Toowoomba, 4 April 2012, CBA.0002.2114.0587, exhibit 4.108.

20

**EXHIBIT #4.108 EMAIL CHAIN STATUS AND UPDATE TOOWOOMBA DATED 04/04/2012**

25 MS ORR: Now, I want to return to the Ruddys, Ms Taylor. And as we discussed yesterday, the Ruddys' facilities were guaranteed by one of their sons?---Yes.

And the amount of that guarantee varied in the period the Ruddys were Bankwest customers?---It did, yes.

30

Now, if we go to exhibit 10 to your statement, CBA.4000.0093.0246. Now, this is the letter of offer for one set of the facilities, the facilities both in Mr Ruddys' name and Mrs Ruddys' name on 21 September 2011. And if we turn to 0249, we see that the initial guarantee given by the Ruddys' son, which is dealt with at 5.1, guarantees 35 indemnities related to the entirety of the facilities?---Yes.

And it was a guarantee in the sum of 795,000?---Yes.

40 And if we go to the other letter of offer at this time, your exhibit 26, CBA.4000.0093.0255, which is the letter of offer for the facility in Mr Ruddys name that was guaranteed both by Mrs Ruddy and by Mr Ruddys' son, we see at 0258 that both Mrs Ruddy and their son guaranteed the entire amount of this facility which was \$325,000?---Yes.

45 So pursuant to these guarantees, Mr and Mrs Ruddys' son was legally responsible for paying back the entire facilities if there was default under the loans?---Yes.

And you heard Mr Ruddys' evidence yesterday that he had understood that his son's guarantee would be limited to his share of Arranfield?---Yes.

But that was not the case in respect of either loan facility?---At this time, no.

5

And do you know why that was the case?---I haven't found anything documented to indicate why it has been structured in this way.

Okay. The position then changed in July 2012; is that right?---Yes, I did see an email on the file that said that the guarantee should be limited.

10

And in July 2012 there were letters of variation that changed to what had previously been contemplated, which was that the Ruddys' son's guarantee would be limited to his share of Arranfield?---Yes.

15

And what led to that change of position?---I can't see anything in – there was one email from the relationship manager which just indicated that the change should be made. There's nothing documented to explain why it was changed in that instance.

And that limited guarantee remained in force until May 2013?---Yes.

20

And in the May 2013 letters of variation Bankwest sought to reinstate the original position that Mr and Mrs Ruddys' son would guarantee the full amount of each of the facilities?---Yes.

25

Now – so I just want to show you what the figures were at that time. If we go to your exhibit 28B, CBA.0517.0167.4008. So this is a May 2013 letter of variation. And if I could ask you to look at 4010, this relates to the two facilities in Mr and Mrs Ruddys' names. We see at clause 5.1 that, in respect of those facilities, Mr Ruddys' son's guarantee moved to the amount of \$955,000 at that point?---Yes.

30

Up from the original \$795,000?---Yes.

So it was 795 for these facilities originally, then it moved to his share of Arranfield, and then in May 2013 Mr Ruddys' son was guaranteeing \$955,000 on these facilities?---Yes.

35

And for the other facility, the facility in Mr Ruddys' name, the same thing happened. At this time Mr Ruddys' son moved to being a guarantor for the entire facility which was \$325,000?---Yes.

40

So what was the basis for that change in May 2013?---Again, in my review, I haven't found any emails or any indication for the reason of those changes.

You can't exchange that?---Can't explain it.

45

But this change in May 2013 was carried across into the June 2013 letters of variation that replaced these letters of variation. You recall those yesterday?---Yes.

5 So did Bankwest use the LVR breach that flowed from the May 2013 revaluations as an opportunity to impose a more onerous position on Mr and Mrs Ruddys' son as guarantor?---I don't believe so. I have found no evidence to support that.

But you don't know why it was done?---I don't know why it was changed, no.

10 But it was done at the time of the LVR breach?---Yes.

Was it common practice within Bankwest to vary the amount of a guarantee on an almost yearly basis, as we've seen here?---I'm not aware of it being common practice at that time. It certainly isn't now.

15 And are you troubled when you look at the changes of the value of the guarantee over this period?---I'm troubled that the guarantee changed, you know, it was – started off in one way, changed, and then was changed back. There's no explanation as to why it wasn't maintained with the facilities, but limited to his interest in  
20 Arranfield.

And Mr Ruddys' son lodged a separate dispute with the Financial Ombudsman Service about the guarantees?---Yes, I believe he did.

25 And he alleged that he hadn't been provided with information about the loans before signing the guarantees?---Yes.

And he said that he believed his guarantee at all times was limited to his share of Arranfield?---Yes.

30 But FOS didn't issue a recommendation or determination because the matter fell outside its terms of reference?---That's right.

35 Thank you. All right. Now, the Ruddys' matter proceeded to farm debt mediation in August 2016?---Yes, it did.

40 And you exhibit to your statement a copy of CBAs farm debt mediation policy. And that's at exhibit 7 to your statement. CBA.0001.0243.0382. Now, this is described in the document as "as at 21 August 2017"?---Yes.

Is it the current version of CBAs farm debt mediation policy?---From what I understand, yes.

45 And you tell us in your statement that it's in materially identical form to what it would have been at the time that the Ruddys' mediation took place?---Yes.

And we see at 0382 the first page, that the document sets out CBAs general approach to farm debt mediation?---Yes.

5 And what I want to put to you that in this document, like the document about dealing with FOS that I took to you yesterday, we see CBA expressing concerns about public perception in its handling of farm debt mediations?---Sorry, I'm just trying to find that part.

10 Could I direct you to the second paragraph in the document?---Yes. I see a statement that says "the bank to handle matters with integrity and compassion".

Well, what we see is:

15 *A farmer's plight also attracts the sympathy of the Australian public, media and political parties. So how we handle the farmer's financial difficulty is often scrutinised by such forums, and our brand can be at risk.*

?---Yes.

20 So a concern about public perceptions in the way CBA handles farm debt mediations?---I think this refer – from my read, refers to the way CBA handles farmers in difficulty as opposed to specifically – what they're saying is agreement through farm debt mediation helps to achieve this.

25 Well, this is in a document that relates to CBAs approach to farm debt mediation?---Yes, it is.

Yes. Then we see:

30 *Therefore, it is incumbent on the bank to handle such matters with integrity and compassion, which doesn't mean we give them more money - - -*

?---Yes.

35 Continuing:

*...to ensure we do the right thing and our brand is protected. Agreements through farm debt mediation helps achieve this.*

40 ?---Yes.

45 So does CBA feel an imperative to settle matters at farm debt mediation?---So I don't actually work in the area that deals with farm debt mediation. From the discussions that I've had with people that do, there is a commitment by CBA to utilise farm debt mediation to reach a resolution for both parties - - -

Okay?--- - - - that is fair and equitable.

Now, broad agreement was reached between Bankwest and the Ruddys at the farm debt mediation that they had. You tell us that in your statement?---Yes.

5 But following the farm debt mediation there was a significant amount of back and forth between Bankwest and the Ruddys' representative about the details of the agreement?---There was, yes.

And that went on for a number of months?---It did, yes.

10 And on a number of occasions during that back and forth the representative for the Ruddys expressed the view that the terms that Bankwest were seeking to formalise in the deed departed, and extended beyond what had been agreed on the day at the farm debt mediation?---That's what they said, yes.

15 And that was a contributing factor to the delay between the day of the mediation and the execution of the deed in October 2016?---Yes. I spoke to the person from Bankwest who attended. They thought there had been agreement on the day and there was a dispute post.

20 So by the deed of agreement the Ruddys agreed to sell Sunrise within six months, and pay Bankwest 75 per cent of the net sale proceeds, as well as an additional 410,000 to discharge the Arranfield mortgage?---Yes.

25 And you heard Mr Ruddys' evidence about the steps that he had to take to comply with that agreement and make those payments?---Yes.

And you heard his evidence that since that time he has been unable to refinance?---Yes.

30 Now, you were asked to reflect on Bankwest's conduct in respect of Mr Ruddy in your statement?---Yes.

35 And you made a number of admissions of conduct falling below the community's and Bankwest's standards and expectations?---Yes.

But you did note in paragraph 138(a) of your statement that, notwithstanding the erroneous valuation, it was likely that Bankwest would nevertheless have offered the facilities to Mr and Mrs Ruddy?---Yes.

40 And you say this is because, in your view:

*Bankwest assessed the application appropriately. Its assessment showed the repayments were affordable and the terms of the lending were properly disclosed.*

45 ?---Yes, that was my understanding in reviewing the file.

And that's the position that Bankwest has maintained throughout, including before FOS?---Yes.

5 And in the farm debt mediation?---Yes. And that was a determination made by FOS as well.

10 Well, you accept that whether the – whether Bankwest would have offered the facilities is a very different question to whether the Ruddys would have accepted those facilities had they understood their true equity position?---Yes.

15 Thank you. All right. Now, in the final paragraphs of your statement you reflect upon how Bankwest's policies have changed since the original valuations that were obtained in 2011?---Yes.

15 And you say at paragraph 139 of your statement that:

*Bankwest would not deal with this in the same way today.*

20 ?---Yes, that's right.

But Bankwest still permits internal valuations to be undertaken in respect of rural properties?---Yes, it does.

25 Okay. Now, could I ask you to look at the current policy, which is exhibit 88 to your statement, CBA.4000.0086.1405. Now, we see there on the first page, 1405, Methods of Rural Valuation. If we could have that blown up. So Bankwest permits internal valuations to be conducted by both internally badged register valuers, who are badged by commercial valuations business credit?---Yes.

30 And sales professionals?---Yes.

Now, do internally badged register valuers and sales professionals have KPIs relating to loan origination?---Yes, they do.

35 What are those KPIs, Ms Taylor?---There is a 10 per cent KPI for asset growth.

Both for the internally badged register valuers and the sales professionals?---The internally badged registered valuers are sales professionals.

40 They are sales professionals as well?---Yes. Yes, they are.

I see. So each of those categories of people who can conduct internal bank valuations have KPIs that include 10 per cent for asset growth?---Yes.

45 And how are the internally badged register valuers meant to achieve asset growth?---Through writing loans.

Through writing loans?---Yes.

And same with the sales professionals?---Yes.

5 So the people who are conducting your internal bank valuations still write loans?---Yes. Just on the sales professional, though, the sales professional doesn't actually carry out a valuation. You see, if you read further down - - -

10 Yes?--- - - - they can provide other sources of external valuation material, such as a sales note from an auction as – as an actual proof of a value - - -

15 Yes?---It's not that they go out and actually internally value – do a property valuation. It's only the internally badged valuers that can actually go out and value a property. And they're the people that I mentioned yesterday have had the training to be able to do that, and all of their valuations are checked by a registered valuer.

So why are they listed here then as one of the two types of people who conduct internal bank valuations?---The sales professional, you mean?

20 Yes?---It's – it's – I believe it's terminology, because as you read through the information they can use to provide that is actually external information from external sources.

25 Okay?---They can't do it themselves. The only people that can actually value themselves have to have done the qualification and have the – be badged – be on the list of accredited valuers, of which there are 11 in Bankwest currently, and they have to have all their valuations checked by an external valuer.

30 So does Bankwest consider that giving these people who have KPIs related to asset growth the role of conducting internal bank valuations, in either of the two ways you've described, might place them in a position of conflict of interest?---So as long as – so my view, as long as these are actually checked by someone else to validate that they're correct, and all of the inputs are checked, which is what now happens, then they have been validated by another party who's not involved in that transaction and not rewarded for that transaction, then I – I don't have an issue with it.

40 So how does that person who checks them validate that they are correct?---They're a registered valuer. They've been a registered valuer for 20 years. They compare against both external and internal data. I think I refer – I mentioned yesterday, we don't do a lot of internal valuations. There have been 24 over the last three years across the 11 registered valuers that we have.

45 And in general terms rural properties can be valued by the internally badged register valuers if the credit facility that's being offered is for 15 million for less?---Yes, but the majority of those 11 have delegations far below that.

What are their delegations?---Their delegations are 3, 5 and I think above 10.

Now, you say in your statement that:

5 *Bankwest has implemented increased controls through the origination process, including a requirement that all valuations performed by internally badged valuers are to be reviewed and assessed by an independent risk professional within the risk management team.*

10 That's what you've just referred to?---Yes, that's right. And they're a registered value not just a risk professional.

Where do we see this policy?---I think it's on the next page.

15 Okay. Could we turn to 1406?---Sorry, it might be the last page. Yes. If we could – I think it will be the last page.

1407 is the second last page, and 1408 is the last. Perhaps if they could both be on the screen?---So the review and accuracy check is the random sample which also happens.

20 So that's something different?---Yes, it is. But - - -

A random sample?--- - - - there is – there is a – on the policy document that we have, it does not – and I have checked that it has the check by the registered valuer - - -

25 So - - -?--- - - - who works in risk.

So it's not in this document?---It doesn't appear to be on this document, but - - -

30 THE COMMISSIONER: Well, can we go back to 1407. And you see there a table. Beneath the table you see two notes, and under the second of those notes:

*Valuations for rural properties greater than 5 million must be co-signed –*  
35 in particular ways. And then a second note. What do I make of those parts of the document?---So the – for the – for that one, if it is over 5 million, there's a co-signing, which has to be done by one of the following, and the – the teams are the state manager, senior relationship manager. So there's a co-signing of anything over 5 million. The - - -

40 And the next note?---The what, sorry?

45 And the next note, what do I make of that?---Sorry, yes. And – and all of the valuations are sent to CVBC, which is the internal valuer, who works in the risk department, and is the person that has to approve all internal valuations.

MS ORR: So is that what you're referring to, the "forwarded to CVBC for their review"?---Yes.

“Must maintain a record of the review”?---And acceptance.

“And acceptance of all internally badged valuations”?---Yes.

5 That’s what you’re referring to?---That’s right, yes.

Thank you. All right. So in - - -

10 THE COMMISSIONER: Just while you interrupted about that, the review depends on the quality of the information they’re given, I take it. It is a review on the papers, isn’t it?---It is a review on the papers.

15 So, for example, specification of the area of the land concerned is not something they check separately?---They would do a detailed check based on the information that they have been provided with and a comparison with others, but yes.

Yes.

20 MS ORR: So that system may not have picked up the errors with this bank manager’s valuation?---Well, I would say it would, because I picked up the errors in that valuation and I’m not a registered valuer or an internally badged valuer.

But plenty of people in your organisation before you did not - - -?---Absolutely.

25 - - - Ms Taylor. You agree with that?---I do agree with that, yes.

30 Thank you. So, in general terms, rural properties can be valued by the sales professionals, not the internally badged register valuers, but the sales professionals, if the credit facility being offered is for 12.5 million or less?---It – yes, yes.

And for valuations greater than 5 million, we saw from the part that the Commissioner just took you to, that the sales professional has to have the valuation co-signed?---That’s right, yes.

35 But beneath 5 million there’s no requirement for that?---It’s an internally badged valuation, it still has to go to the internal – the registered valuer who sits in risk. They all go if they’re internally badged.

40 But these are not internally badged. I’m talking about the sales professionals?---So the sales professionals are using external data from already registered - - -

Yes?--- - - - and authorised people, so therefore they have the co-signing and that data will also be checked by risk when they do the credit application as well.

45 But they only have the co-signing over 5 million, not - - -?---Yes, sorry, yes.

Not below 5 million?---Yes, that’s right.

Now, I want to ask you about that random sample check on 1408:

*A random sample of valuations completed by sales professionals is reviewed annually to check for accuracy, and adherence to policy.*

5

?---Yes.

So what are the matters that are being assessed in that random sample?---So the random sample is a – it's a sample of 10 per cent of the valuations to ensure that they have been carried out correctly and that the data that's in them is accurate.

10

Okay. And we see that the policy tells us that:

*If a manager is found materially overstating a property value, the sales professional risks losing their valuation privileges and may face further action from the bank.*

15

?---Yes.

But there isn't an equivalent requirement in relation to the internally badged valuers?---So the internally badged valuations, because they have that check by risk, they are returned to the business if they're incorrect. We have a register of – a register of what we call LGA breaches, which is delegations breaches, so in the event that someone was seen to be having a significant number of errors with – whether it be valuations or any other element of an application, that would be investigated and they would either be – receive training, or if the behaviour continued, there would be consequences, both from the perspective of their STI, as well as it would affect their – obviously their risk ..... which I talked about yesterday, and it moves through seriousness to formal warnings and dismissal.

20

25

So why does Bankwest consider it necessary to specify for sales professionals to spell out in this policy that if they're found materially overstating a property value they risk losing their valuation privileges and may face further action from the bank?---From my perspective, to ensure that they understand the seriousness of getting – as with everything in an application – making sure that it's accurate, and they know that it's actually being looked at and checked. That's the purpose of having these types of controls.

30

But if there are risks like that inherent in allowing sales professionals to discharge the function, why does Bankwest permit them to do it?---Because the checks are in place to make sure any adverse behaviour is caught.

35

So under the current policy it remains the case that someone in the position of the bank manager could complete an internal valuation in respect of properties such as Arranfield and Sunrise?---If they're internally badged, yes. If they're a sales professional they would have to use external data. Some of that external data includes an external valuation that's 12 months old.

40

45

And if they're badged at least one other Bankwest employee has to review it?---If they're badged, it has to go to the registered valuer who sits in risk who checks every element of that valuation.

5 Yes. Okay. But as I have already pointed out to you, internal review by Bankwest was insufficient in 2012 to identify all the defects in these valuations, wasn't it?---It was, but it's very different now.

10 Now, Bankwest accepts that where a customer pays for a valuation they should generally receive a copy of the valuation?---Yes, that's correct.

15 But Bankwest also tells the Commission that the customer should not receive a copy where providing them with a copy might negatively impact the sale price of the asset. Now, I'm reading that from submissions that were made to the Commission within the third block of hearings?---Yes.

Are you familiar with that document?---I am, yes.

20 So the position of CBA and Bankwest is that customers should not receive a copy of a valuation where providing them with a copy might negatively impact the sale price of the asset?---The – I think the context of that comment related to enforcement action, and it specifically relates to the sensitivities around the price of the asset at that time, and the potential for manipulation of the outcome in the event that the information was shared. I believe there was evidence given by CBA to that effect.

25 So other than in that quite specific enforcement setting - - -?---Yes.

30 - - - Bankwest's position is that customers should receive copies of valuations?---That they've paid for, yes.

Thank you. I have no further questions, Commissioner.

35 THE COMMISSIONER: Just before you – before you – before I call on Mr Scerri, you spoke of valuers and sales professionals having 10 per cent of KPIs for asset growth. Do I understand that correctly?---Yes.

Do they also have a KPI for profitability?---They do have a KPI for profitability.

40 Can you explain to me what that is measuring?---The profitability – well, it's a revenue KPI. So it's the revenue generated on their portfolio through all of the products they sell, not just loan products.

45 So that the incentive offered is to sell products to clients that are as profitable as can be?---No. So the way the KPIs are structured, there's a – a – an asset growth KPI and there's a revenue KPI, which make up no more than 40 per cent of the overall KPIs. So 60 per cent of the KPIs of the bankers don't relate to any financial measure. So the encouragement is to have a good strong relationship with

customers, understand the products that they need, and fulfil those needs for customers. That is the role of the banker.

5 40 per cent of KPIs are financial?---40 per cent are financial. However, the risk gate opener has to be met to be eligible for any payment and the behavioural elements all have to be met as well. So if someone is consistently breaching from a risk perspective they will not be eligible for an incentive and if they do not display the correct behaviours and not behaving in the way we respect with customers, again, they will not receive an incentive.

10 THE COMMISSIONER: Yes. Thank you. Is there anything arising out of that, Ms Orr?

15 MS ORR: No, Commissioner, thank you.

THE COMMISSIONER: No. Mr Scerri.

MR SCERRI: Sir, before I start, can I just mention a couple of matters to Ms Orr. She may want to have some more questions about them.

20 THE COMMISSIONER: Yes.

MR SCERRI: Excuse me, sir. Sir, the first matter is I need to correct the instructions I gave – that I passed on about when we received the documents that I said we received yesterday at 4 pm. In the case of two documents – and I will give the numbers in a minute – we have now ascertained that we did receive them on 29 May. And that’s – we found that out by comparing the ID numbers. And the two – the two documents concerned are CBA.0002.2115.3931 and CBA.0002.2115.1814. And again, Commissioner, we apologise for that. The other matter is a matter that Ms Orr will take up with the witness.

THE COMMISSIONER: Which are the two documents – I know you’ve given the doc IDs, but which are those two documents, Mr Scerri?

35 MR SCERRI: Sorry. I know that the one that ends in 3931 is exhibit 4.107. And the second one, I don’t have a note of the exhibit number, and I’m not 100 per cent sure it was tendered.

40 MS ORR: No. That one wasn’t tendered. The one that was tendered, Commissioner, was the briefing note with Jenny prior to meeting with Harrison Young.

THE COMMISSIONER: I see. Well, I will – as I say, I will consider what course is to be taken in relation to these matters.

45 MR SCERRI: Of course.

THE COMMISSIONER: Yes. Go on.

MS ORR: Now, Mr Scerri drew to my attention this morning, Ms Taylor, that when you were being shown the documents that were provided overnight, you told him  
5 that there was a matter that you wished to correct - - -?---Yes.

- - - from your evidence yesterday?---Yes. So yesterday you showed me the FOS  
determination and asked me if it was included in my table in the 3. And it is  
included, it is the second one down where the compensation by FOS was 300 – sorry,  
10 \$3000.

Could you just give me a moment to look at your reference to that determination.  
That was in paragraph 32 of your statement, CBA.9000.0070.0011. Now, it's 32  
where you explained - - -?---Yes.

15 - - - the circumstances of the three FOS matters that had reached recommendation or  
determination wholly or partly in favour of the customer?---Yes.

Did I understand you to say that the determination I took you to yesterday is the  
20 determination referred to in 32A, which concerned a customer who disputed the  
structure of their lending and requested a refund of fees and charges?---Yes, it is.

So is there any reason, Ms Taylor, why you didn't describe that FOS determination  
as relating also to issues between a valuation in 2010 and a valuation in 2013 that led  
25 to an LVR breach?---At this – at the time that I was actually pulling the statement  
together, the issues arising from the banker had not come to full light, and I have  
only in the last few weeks been able to start to put that together.

So you didn't know at this time that the bank manager was involved in that  
30 determination?---No, I didn't.

I understand that. But even without knowing that the bank manager was involved, it  
was apparent from the face of the determination that one of the primary issues that  
the applicants agitated in FOS was an LVR breach based on a difference between a  
35 2013 and a 2010 valuation?---Yes.

Is there any reason you didn't mention that in your description of the FOS  
determination in paragraph 32(a)?---At the time that I drafted, I – I wasn't looking at  
it in that way. I apologise.

40 And do you think now that they're the same determination because of the reference  
to the \$3000 figure?---The – they are the only three that we've had, and I know that  
the – that we did do the research across all of the files, and so that is absolutely that  
one, yes.

45 So do you accept that your description of that matter was incomplete - - -?---Yes.

- - - in paragraph 32(a)?---Yes, I do.

And would not have enabled us to identify - - -?---Certainly did not enable me to identify, yes.

5

Yes. Thank you. I have no further questions, Commissioner.

THE COMMISSIONER: Yes. Yes, Mr Scerri.

10

<RE-EXAMINATION BY MR SCERRI

[10.58 am]

MR SCERRI: Thank you, sir.

15

Ms Taylor you were asked some questions about the guarantee that the Ruddys 'son gave?---Yes.

Did the bank enforce that guarantee at all?---No, they did not.

20

Thank you. Could the witness be shown exhibit 4.94, please, your – Commissioner.

THE COMMISSIONER: That's CBA.0001.0393.0082.

25

MR SCERRI: Ms Taylor, you will recognise this document from yesterday?---Yes.

And it's the one about the business CEO awards?---Yes, that's right.

30

And you were asked some questions – it's at transcript, for the record – 3465. You were asked some questions about whether these awards were given for anything other than sales or financial performance?---Yes.

If you look at the – even that first page, is that answer correct, if - - -?---No, it's not.

35

If you look at those – the first item and you look at the third item, and if you go to the next page, if you look at the item that's – it should be page 0083, yes – if you look at the items down the bottom, see the one at the bottom, the very bottom?---Yes.

40

And if you look at the one above – the one that's one, two, three – third from the bottom?---Yes.

And the one that's fourth from the bottom?---Yes.

45

If we go to the next page, you will see that the first one talks about – sorry, that's the one – talks about customer service?---Yes.

And so does the second one?---Yes.

The second one talks about team – team work, the third one talks about customer services. So is it correct to say that the awards are given only for financial performance?---No, it's not. They're given for service and team work as well.

5 Thank you. Could I – could the witness be shown exhibit 38A, Commissioner, and it starts at CBA.4000.0096.0404. I meant exhibit ST-83A to her statement. Just while we're going to that, Ms Taylor, I should have asked you before: the result of the mediation was that the bank wrote off some of the Ruddys' debt, wasn't it?---Yes. The bank wrote off over \$600,000.

10 Thank you. Have you got that exhibit in front of you?---Yes, I do.

Could you go first to page .1449. And I just may need some help as to how to read this. This is the bank account statement - - -?---Yes.

15 - - - of the Ruddys. And if you look at page 1449, and there's an entry for 30 April?---Yes.

20 You see that? And the balance, is that – it's a debit balance of 264,000?---Yes.

And then beneath that, against the date 28 March, there – a heading called Debit Interest Rates, and then next line down, 01 agribusiness limit, 200,000?---Yes.

25 Next line down, temporary business limit, \$40,000?---Yes.

What do those limit figures mean?---The 200,000 is the limit on the agribusiness overdraft account. The 40,000 is a temporary excess that has been granted and applied to the account.

30 And does that mean those limits apply from 28 March. Is that the date?---Yes, it is, yes.

35 And does it mean they would have been applying – or been applicable as at 30 April?---They would have, yes. Yes, they would have.

Does that mean that as at 30 April they were – the Ruddys were more than \$24,000 over both limits?---Yes, they were.

40 And could you go – sorry – could you go to page 1451. And you will see at 20 May there's an entry about the limits again?---Yes.

Does that mean that by then the limit had – the \$200,000 limit was the same, but the temporary business limit had been increased to 60,000?---Yes, it did, yes.

45 By providing another 20,000 temporary business limit?---Yes, that's right.

And if you look at – on that same page, please, Ms Taylor, at 31 May the balance was 247,000?---Yes.

And if you look up the page there's a figure of 253,000?---Yes.

5

At 27 May. And if you go to the following page, please – sorry, I meant page 1453. You will see that 31 May, the limits are 200,000 plus a temporary limit of 60,000?---Yes.

10 And the balance at the end of June – well, 26 June, it's 253,000, and then there are several debits, and then there is a credit on the 28<sup>th</sup>, so that brings it back to 228,000, which is within the limit. If you go to 1455, and you will see at the bottom of the page, on 15 July, we have the limits again. And this time there is the limit of \$270,000?---Yes.

15

About which you gave evidence yesterday?---That's right, yes.

And you will see that the balance at 31 July was \$265,000?---Yes.

20 So it was within limit. If you look at the next page which picks up from the August date, you will see it starts with the 265. And there are – I think yesterday you said there are cheques being presented during this period?---Yes, that's right.

Is that what the debit column indicates?---Yes, that's right.

25

And there are a number of credits. And we get to page 1457, you will see the balance is \$271,000?---Yes.

The limit is still \$270,000?---Yes.

30

And if you look at page 1458, it gets – it's still 271,000. Then it goes up, 277,000?---Yes.

And I think it's fair to say it doesn't reduce very much after that?---That's right.

35

Is that correct?---Yes, that's correct.

Is that what you meant when you said a couple of times, yesterday and today, that in your view the bank was supporting the Ruddys to try and keep the business going to – in response to the events that had happened that were affecting its cash flow?---Yes, that's right.

40

Thank you, Ms Taylor. Are there any questions arising out of that, sir?

45 THE COMMISSIONER: No, thank you.

MR SCERRI: Thank you.

THE COMMISSIONER: Thank you, Ms Taylor. You may step down. You're excused.

5 <THE WITNESS WITHDREW [11.07 am]

THE COMMISSIONER: Mr Scerri - - -

10 MR SCERRI: Yes, your Honour – Commissioner.

THE COMMISSIONER: - - - given your instructions about the time of receipt of the documents produced last night changed during the course of this morning - - -

15 MR SCERRI: Yes, your Honour.

THE COMMISSIONER: - - - if further investigation were to reveal that some additional change were necessary to reflect the position, I would expect the solicitors assisting the Commission to be informed of those matters and of that change in writing no later than close of business Tuesday, 3 July. Just to be sure that I understand the position as it presently stands, I understand you to tell me that two documents, namely CBA.0002.2115.3931, and CBA.0002.2115.1814, came into the possession of your instructing solicitors on 29 May last, and that the other documents produced last night were received by them at 4 pm yesterday, 28 June.

25

MR SCERRI: That's my – they are my instructions, your Honour.

THE COMMISSIONER: Yes. Very well. Yes, Ms Orr.

30 MS ORR: Commissioner, we turn now to a case study involving NAB. So if we could perhaps have a short break to allow NABs counsel to - - -

THE COMMISSIONER: 11.15 sufficient?

35 MS ORR: Thank you, Commissioner.

**ADJOURNED** [11.09 am]

40

**RESUMED** [11.15 am]

THE COMMISSIONER: Yes, Mr Costello.

45

MR COSTELLO: Commissioner, the next witness is Deborah Smith.

<EXAMINATION-IN-CHIEF BY MR COSTELLO

5

THE COMMISSIONER: Thank you very much, Mrs Smith. Do sit down. Yes, Mr Costello.

10 MR COSTELLO: Thank you, Commissioner.

Your name is Deborah Smith?---Yes.

And what's your occupation?---Grazier.

15

And your address is Limbri Downs, which is near Hughenden in Queensland?---Yes.

Did you attend today in answer to a summons served on you by the Commission?---Yes.

20

I tender that summons.

THE COMMISSIONER: The summons to Mrs Smith is exhibit 4.109.

25

**EXHIBIT #4.109 SUMMONS TO MRS SMITH**

30 MR COSTELLO: And Mrs Smith, have you prepared a statement at the request of the Commission?---Yes.

And do you have that statement with you?---Yes.

Are the contents of that statement true and correct?---Yes.

35

I tender that statement.

THE COMMISSIONER: Exhibit 4.110, statement of Mrs Smith.

40

**EXHIBIT #4.110 STATEMENT OF MRS SMITH**

45 MR COSTELLO: Mrs Smith, are you married?---Yes.

And what's your husband's name?---Kenneth Noel Smith.

And does he go by Ken?---Ken, yes.

And what does Ken do?---He's a grazier.

5 And how long has Ken been a grazier?---All his life, apart from a short stint of timber cutting in the early days after school.

How many years do you think he has been a grazier?---40 years.

10 And how long have you been a grazier?---30-odd years.

And do you have any children?---Yes.

And are either of them on the farm?---Yes.

15

How many children do you have?---Two.

And which one is on the farm?---The daughter.

20 And does your son help at the farm at all?---Yes.

How often?---As often as he can, as he works in the mines.

25 All right. Now, you mentioned that you live on Limbri Downs. Do you call that property Limbri?---Yes.

Or is it Limbri?---Limbri.

30 All right. And do you and your husband own that property?---We mortgage it, yes.

All right. When did you buy it?---1985.

And you run cattle there?---Yes.

35 And whereabouts is that property?---West-south-west of Hughenden.

How far - - -?---approximately 43 kilometres.

40 To Hughenden?---Yes.

And what's the closest major city to Hughenden?---Charters Towers.

All right. And how far is from Hughenden to Charters Towers?---Approximately 240 kilometres.

45

And what about to Townsville?---350 kilometres.

All right. Now, how many acres is Limbri?---28,000, or – or just under 29,000.

Okay. And what sort of country is it?---Open downs, black soil country.

5 And what type of cattle farming is that country good for?---Best suited for fattening.

And what age do you start fattening?---From weaners.

10 And when do they – when do you take them off the mother and start weaning?---Approximately six months old.

What type of cattle do you breed?---Brahman Cross.

15 Exclusively Brahman Cross?---Yes.

All right. Now, you have been on Limbri since 1985, do you say?---Yes.

20 And what are the weather conditions there normally like over the time you've been there? How many good seasons do you have to bad?---Usually you will get eight good seasons in 10.

And the other two?---A little dryer than average.

25 How many cattle can you run on Limbri?---Depending on their ages, but 1400 grown cattle.

And who do you sell cattle to?---To the feedlots, the backgrounders, and the abattoirs, and some through the sale yards.

30 Do you sell any for live export?---Yes.

Where do you sell most of your cattle into?---In – in the last few years, they have gone to export.

35 Right. And you sell some into the abattoirs?---Yes.

And where is your nearest abattoir?---Townsville.

40 All right. And if you are sending cattle for live export, where do you send them?---Charters Towers or Townsville.

Depending on what?---Depending on the delivery address.

45 Right. I see. Now, at some point in time you had a lease on another block?---Yes.

And do you remember what that block was called?---The Stanford Reserve.

And when do you think you took a lease on that block?---Prior to 2005.

And who did you lease it off?---The Flinders Shire Council.

5 And is that nearby to Limbri?---Yes.

How close?---20 kilometres.

10 And why did you take that lease?---Our cattle were expanding, our – the few breeders that we had, and Limbri is not mostly suited to breeders, that we had to find somewhere else to put them on.

All right. And when did the lease on that block end?---Approximately 2003.

15 Okay. And why did you end the lease on that block?---We purchased a block in the Northern Territory.

When did you purchase a block in the Northern Territory?---The end of 2002.

20 And whereabouts was that property?---Near Borroloola.

And where is Borroloola?---It is in the western gulf.

25 Is that near the McArthur River mining area?---Yes.

All right. And did that property have a name?---Broadmere.

Broadmere?---Yes.

30 And why did you buy that property?---It was getting dry in the Hughenden area, and it – there wasn't sufficient feed around Queensland to put them – to put our cows on, so we went further afield and purchased a property in the Northern Territory.

35 How big was that property?---Quarter of a million acres.

And did you or Ken move to the Northern Territory property, Broadmere?---No. We ran it from our home base of Hughenden. We had caretakers that looked after the water and fences.

40 And what type of cattle did you have on Broadmere?---Brahman Cross.

Were they breeders?---They were our breeders, yes.

45 Right. And so was the idea to have the breeders at Broadmere, and the weaners brought down to Hughenden?---Yes.

And how many cattle can you run on Limbri? 28,000 acres?---Depending on – depending on the size of the stock, 1400 head of grown cattle.

That's grown and growing?---Yes.

5

How long do you typically fatten them for before you sell them?---Depending on what markets they were going to, at least 12 months.

Okay. So if you're selling into the abattoirs, would it be 12 months?---The biggest steers, yes. Cows may have had to have ..... out and fatten before they went.

10

All right. And what about the live export; is that the same?---Yes.

Okay. Now, you mentioned one reason you bought the property in the Northern Territory was it was getting dry in Queensland?---Yes.

15

And you bought that property and you got rid of your lease that was nearby Hughenden?---Yes.

And was part of the reason that having properties in different areas gave you a bit of drought protection?---It does, yes.

20

Okay. Do you remember what the weather conditions were like on Limbri in 2002, 2003?---Dry.

25

All right. And did you keep cattle on Limbri when it was dry or - - -?---Only the weaners that were taken off the cattle that were sent to Broadmere.

I see. So how many weaners do you think you would have kept on Limbri at that time?---There was only about 100 head, I think.

30

100 head?---Yes.

And I think you said earlier that you think Limbri could hold about 1400?---Yes.

35

Okay. And how many did you have on Broadmere?---We sent there 3000 head.

Okay. On trucks?---On trucks, yes.

And how long did you keep cattle at Broadmere for?---For three years.

40

Okay. Does that mean late 2005 or 2006?---2005, yes.

Okay. And what did you do at the end of 2005?---We purchased a property near Pentland and shifted our breeders from the Northern Territory property to the Pentland property.

45

And what did you do with Broadmere?---We sold it.

Okay. And the Pentland property, does that have a name?---Oakvale.

5 And so that's near Pentland. Where is Pentland compared to Limbri?---Pentland is 110 kilometres west of Charters Towers.

West of Charters Towers?---Yes.

10 So how far then between Limbri and Oakvale?---Approximately 250 kilometres.

And what type of land is Oakvale?---Oakvale is rich in mineral country.

15 And what type of cattle is that type of land good for?---Best suited for breeding.

Why is that?---Timbered country, a little safer rainfall.

20 Not as lush?---Not as – not – not – not as lush, a bit – a lot – I suppose you could call it harder country than Limbri, the Hughenden block.

So Oakvale was, in effect, a replacement for Broadmere?---Yes.

But it was a lot closer?---Yes.

25 And was that one of the reasons you bought it?---Yes.

And is Oakvale in the same weather region as Limbri, or do they have different climates?---They have different climates.

30 Okay. Does one typically get more rain than the other?---Yes.

Which one?---Oakvale.

35 And when is the wet season typically for Oakvale?---January, February, March.

And it's the same for Limbri?---Yes.

Because Queensland summer is when you get the rains?---Yes.

40 All right. When you bought Oakvale, do you recall who you banked with?---Suncorp-Metway.

45 Okay. I just want to show you a document. It's NAB.005.512.0115. While that document is coming up, can I ask you this: at some point you changed to NAB. When was that?---2008.

That's after you bought Oakvale?---Yes.

Okay. This is a letter which I should say for the transcript, Commissioner, is tab 21 of the exhibits to Mr McNaughton's statement. If we could just go to the second page of that document – actually, could we bring both pages up side-by-side. So this is a letter that you wrote in 2007?---Yes.

5

And while it's not immediately apparent, I think this is a letter that you wrote to the NAB; is that right?---Yes.

10 And did you write this letter because you were with Suncorp-Metway, as it was then called, and you were thinking about moving to the NAB?---Yes.

And how did you come to think about going to NAB?---It was one of the – one of the banks that had a branch in Hughenden.

15 And was it important or useful to you to be banking with a bank that had a branch nearby?---Yes.

That was helpful?---Yes.

20 All right. And did anyone from NAB approach you or did you approach them?---I approached them.

And how did you do it?---Via this letter.

25 Via this letter. You just wrote to them?---Yes.

Okay. And did you give them a bit of detail about your operation?---Yes.

30 300 head of breeders, three state forest leases. Are they – were they – was it three leases, but all in the same area? Were they side by side or were they different properties?---No, they weren't side by side. They were apart to each other.

I see. Did you get rid of each of those three leases when you bought the Northern Territory?---They were forestry leases.

35

I see. You weren't running cattle on them?---So, no, they weren't sold, no.

All right. And it recites there that you purchased and relocated to Limbri in 1985?---Yes.

40

Downs fattening country?---Yes.

And then at the end of 2003 you bought Broadmere in the Northern Territory?---Yes.

45 400 females?---Yes.

Relocated your breeder herd, 2000 head, then there was drought in western Queensland, couldn't find agistment land or available properties for sale in Queensland and that's why you ended up with the property in the Northern Territory?---Yes.

5

You sold that at the end of 2005, for a profit, and you bought Oakvale, which is the property near Pentland, and you put your breeders on there?---Yes.

And you say then that you're currently with Suncorp-Metway?---Yes.

10

Continuing:

*Interest is payable at the end of April and October in a chequing account with an overdraft limit of 600,000, incurring interest of approximately \$5000 per month, which we find is killing us.*

15

?---Yes.

So you had had some difficulty, had you, with your Suncorp facilities?---Yes, we did.

20

And was that in part because of the way that they were structured and the amount of interest that was accruing on them?---I can't remember exactly, but yes, it would have been.

25

Okay. And then at this stage, at least, it says, on the second page:

*Apart from the income coming from the cattle, we agist our paddock at Limbri which brings us 20,000 a month.*

30

?---Yes.

How long did you keep on agisting at Limbri?---I'm not sure exactly at that time, but the - the place was pretty near destock when we went to Broadmere.

35

Right. It then says you work at the sale yards at Hughenden during the day?---Yes.

While your daughter, who was then six, is at school, which brings in \$400 a week. And your son, who was then 21, helps out when home every third weekend?---Yes.

40

So is it about the same now? Does he help out about the same now?---Yes.

About every third weekend?---Yes.

45

Okay. Then you say:

5 *We live on the smell of an oily rag, so to speak, and don't spend money on anything unnecessary, making do and repairing what we can ourselves. The last two financial years we have had some personal expenses that are one-off items and don't happen normally. Two interest payments were late due to relocation and drought, in which Suncorp charged us excessively high penalties for an extra \$80,000.*

?---Yes, that was correct.

10 You were accepting help from the Member for Kennedy. You've had a little help from government bodies. So you weren't entirely happy with Suncorp-Metway?---No.

15 And you weren't happy with them because you felt you had been penalised?---Yes.

And you felt you had been penalised because you had missed some payments. And why did you miss those payments?---Due to seasonal activities.

20 All right. So when you went to the NAB, do you remember what facilities you took out – that document can come down now, thank you?---A loan of 3.1 million, an overdraft of 250,000.

25 And in your mind was the \$3.1 million loan, in effect, the mortgage on Oakvale?---And the remaining of the – the other mortgage from – which would have contained a small portion from the Limbri originally - - -

I see?--- - - - before the Broadmere account.

30 So was the mortgage on, in effect, the two properties?---Yes.

And then you had an overdraft as well?---Yes.

And the overdraft was for your working capital?---Yes.

35 Okay. So that was about 2008 you came across to NAB?---Yes.

In June 2011 there was the live export ban to Indonesia?---Yes, there was.

40 Did that have any impact on your business?---Yes.

How did it affect your business?---It affected the monetary value of cattle, of all cattle, at that time.

45 Right. And did you have any cattle due to go for live export at that time?---We didn't have any initially booked to export.

So the live export ban didn't cancel a booking that you had?---No.

But it affected the price nonetheless?---It did, yes.

And how much did it affect the price that you would get for your cattle, do you think?---Cattle prices plummeted by half, at least.

5

How quickly?---Overnight.

And do you – when you sell cattle, do you usually sell for a dollar value per kilo?---Yes.

10

So what's a good price?---A good price, we still haven't achieved yet.

Right. Well, what's a reasonable price?---Over \$2.50 a kilo.

15 That's a reasonable price?---That's reasonable, yes.

Okay. And do you have any idea or recollection of what the price per kilo was after the live export ban was announced?---For the cattle that we were selling, it was down to less than a dollar a kilo.

20

And how long did prices remain depressed?---I consider it remained depressed until 2015.

25 Did it have any effect on the price of inputs into your business?---Yes. Everything we had to purchase to run our properties, the prices seemed to double.

And do you think that was because of the live export ban or was that just at about the same time?---I think that was, yes, it was just at the same time.

30 Right?---Just lower cattle prices made it a lot harder for us.

Did it make it harder to get cattle into abattoirs?---It did, yes. There was a – there were floods on the market.

35 And is that because cattle that were otherwise meant to be on a ship - - -?---Yes.

- - - suddenly were going to an abattoir?---Yes.

40 All right. And that affected – I think you said your closest abattoir was Townsville?---It did, yes.

Affected the Townsville abattoir. All right. And you think, about 2015, prices recovered from that shock?---They recovered reasonably well.

45 Well, they're never what you want them to be?---No. They're not, no.

That was the middle of the year 2011 when the live export ban happened?---Yes.

Come 2012, what was the weather like on Limbri?---Very dry.

And was it better at Oakvale?---Yes, it was.

5 Did you have any unexpected weather at Oakvale in 2012?---There was a flood.

And - - -?---And it was – it was also dry. It – it’s extremes. Extremes all the - - -

10 All right. Let’s start with the flood first. Do you recall when in 2012 there was a flood?---Early. It would have been early in the year.

All right. And is there any creek or river nearby to Oakvale?---Yes, yes.

15 And where is it located compared to Oakvale?---It runs – it runs through Oakvale.

And it’s a creek, is it?---It’s the Cape River.

The Cape River?---Yes.

20 And is that what flooded?---Yes.

Okay. And did that affect your business?---It did, yes.

25 And how did it affect your business?---Being able to get – because we’re on a dirt road, being able to get livestock to market, and it wiped out a lot of fences.

Was that flood caused by heavy rain in your area, or was it heavy rain downstream, or both?---Heavy rain upstream.

30 Upstream. Yes, that would make much more sense. Good. You will turn me into a farmer yet. So heavy rain upstream came down and, apart from that, Oakvale was dry?---Till near the end of the year, yes.

35 Okay. So Limbri is dry 2012, Oakvale is both dry and flooding in 2012. And then in January 2013 drought was declared at the region that Limbri is in?---The Flinders Shire, yes.

40 Okay. And by the time that drought is declared in early 2013 conditions have been reasonably tough, for a while at least, because of the live export ban. 2012 it was dry in Limbri in any event, 2012 you have a flood at Oakvale?---Yes.

So by the time the drought comes in January 2013 you’ve had some difficult times already?---Yes.

45 Is that fair to say?---Yes.

And what did you do with your cattle on Limbri when the drought struck?---Reduced numbers to help.

Did you move any from one property to the other?---Yes.

5

And did you do that because Oakvale wasn't quite as dry as Limbri?---Yes. Yes.

Okay. And did you eventually destock Limbri?---Yes, totally.

10 When do you think you destocked it by?---Totally destocked it by 2014.

And at the time you destocked Oakvale, about how many cattle – sorry, destocked Limbri, about how many cattle do you think you had on Oakvale?---About 2000 head.

15

Okay. So financially, by late 2012/early 2013 when the drought was declared, were you in a good financial position or was it a bit tight, or was it very hard? How would you describe it?---It was getting quite hard.

20 Okay. And at some point did you get a rural financial counsellor to assist you?---Yes.

Do you know how that came about?---We were applying for some government funding.

25

And as part of that process a rural financial counsellor was assigned to you; is that how it works?---Yes.

I see. And what was the name of that financial counsellor?---John Swain.

30

Then in April 2013 did you get a letter from the NAB because your accounts had fallen out of order?---Yes.

35 I will take you to that letter. It's NAB.148.032.8970. This is exhibit 6 to Ms Smith's statement. Is this the letter that you recall getting?---Yes.

And it's from a senior manager at the bank. And it says:

40 *Dear Mr and Mrs Smith, I refer to the discussions I have held with John Swain who has been assisting you regarding the facilities provided to you by NAB.*

So that's the financial counsellor that had been allocated to you?---Yes.

Continuing:

45

*Your facilities have fallen into arrears and the bank holds concerns as to the viability of your business and is now considering commencing recovery action*

5           *which could include the possible sale of your farming property. I've attached a copy of the Queensland Farm Finance Strategy. It's a voluntary scheme that NAB participates in. You will see that under the scheme the bank has agreed to offer formal mediation to customers when the bank is considering taking action under its mortgages to sell farming property. As the bank is now considering taking action under its mortgages to sell farming property, I have enclosed –*

10           And he has enclosed a notice of their intention to take enforcement action against you, against the property, and the forms for you to respond to the bank?---Yes.

          Respond to the bank. And then they suggest that you get some assistance from various people, including financial counsellors, Legal Aid, or a private solicitor or accountant?---Yes.

15           All right. Do you remember getting this letter?---Yes.

          And what did you think when you got it?---We were very frightened, yes.

20           Did you – had you anticipated something like this was going to happen?---No.

          Okay. But you did know that you were behind in your payments?---Yes.

          And you were having some trouble with your cattle because of the weather?---Yes.

25           Is that right - - -?---Yes.

          - - - at this time?---Yes.

30           Before you got this letter, had you thought about putting one or both of the properties up for sale?---No, no. They wouldn't have been in a condition to sell.

          Because of the drought?---Yes.

35           So in that letter the bank proposed farm debt mediation. Had you been to a farm debt mediation before?---No.

          Did you know some people who had been?---No.

40           Okay. Did you know what it was?---Not particularly, no.

          And did you speak to the rural financial counsellor as the bank had suggested?---Yes.

45           It also says you can get advice from Legal Aid. Did you end up getting some advice from Legal Aid?---Yes.

          And did you speak with Legal Aid directly or did your financial counsellor arrange that for you?---He arranged that for us, yes.

Okay. And did you agree to go to farm debt mediation?---Yes.

And do you remember when that mediation was held?---In September 2013.

5 And where was it held?---Townsville.

And who went to the mediation with you?---My husband.

10 And what about your financial counsellor. Did he go?---Yes.

And the Legal Aid solicitor, and that was Mr McMahon?---Yes.

And you travelled from - - -?---Oakvale.

15 - - - Oakvale to Townsville?---Yes.

How far is that again?---It's two hundred and – yes, 250-odd kilometres.

20 And do you remember if you went up the night before or did you go up the morning of the mediation?---I think we went up there the morning of the mediation.

Okay. And do you remember what time the mediation started?---No, not particularly.

25 Okay. Was it in the morning?---It would have – yes, it was in the morning.

Okay. And what do you remember about the mediation?---It was very intimidating.

30 Why was it intimidating?---We were told that if we didn't sign what documents they had, that we would walk out of there with nothing but the clothes on our back.

What were your expectations going into the mediation?---That we would come to some sort of agreement to be able to settle part of our debts.

35 And do you remember how long it lasted?---It was all day.

Okay. And were you in one room and the bank was in a separate room, or you were altogether in the one room?---No, we were altogether in the one room.

40 Okay. And how long do you think you were there before there was a draft forbearance deed produced?---Midday-ish.

45 Okay. So who was the person principally negotiating that on your behalf?---Bruce Starky.

Bruce Starky?---Yes.

He's from the bank?---Yes.

But who was – who was negotiating for you? He was the person - - -?---Sorry, John Swain.

5

Right?---Yes.

I see. And by the end of the day, had you come to an agreement with the bank?---Yes.

10

And that agreement was set out in the deed of forbearance, and you've annexed that to your statement. I will take you to it. It's exhibit 8, which is NAB.005.451.1023. This the deed that you signed?---This is, yes.

15

And you signed it at the mediation; is that right?---Yes.

Okay. If we move to 1026 of that document. Thank you. Could that just be made a little bit larger. You will see there, there's a definition of facilities:

20

*Facilities means the following facilities provided by NAB.*

And there's a number of different facilities there with the limit and the balance?---Yes.

25

So the overdraft by this stage is up to about 860,000. The term loan is 3.1 million, still. There's a small loan which looks like it relates to a Landcruiser?---Yes.

And then you've got a MasterCard which is maxed out?---Yes.

30

Ken has got a visa, and he's got about, give or take, \$600 available on that?---Yes.

And did you have other facilities with other banks at this time?---Not that I could remember.

35

The NAB was your bank?---Yes. Yes.

Okay. So aside from any money that you had on deposit, at the time of this mediation in terms of available credit, you had a little under \$600 on Ken's visa card; is that right?---Yes.

40

If we then move forward a few pages to 1030. Can you see there in heading 4, Change to Facilities – if that could be enlarged – have you got your hardcopy there?---Yes, yes.

45

Good. Can you see clause (a) ends with:

*NAB will release all claims to the Landcruiser.*

?---Yes.

That was something you negotiated - - -?---Yes.

5 - - - at the mediation - - -?---Yes.

- - - because you still owed some money on the Landcruiser?---Yes.

And you needed the car. All right. And then in (c)(i):

10

*All terms and conditions of the facilities continue to apply to the facilities, including the obligation to pay interest and costs as they fall due at the default rate applying to the facilities. However, if you comply with the deed the bank would –*

15

in (i):

*Rebate \$50,000 to you on account of interest accrued before the date of this document.*

20

Do you remember that?---Yes.

And do you remember your rural financial counsellor negotiating that for you?---I don't remember the financial counsellor negotiating that. I think that was just Bruce Starky's - - -

25

That was just offered by the bank?---Yes, yes.

Okay. In (ii) of (c) it says:

30

*Applying rates of interest from the document date to the date of payment of the amount owing on the basis that no default had occurred under the facilities.*

Did you understand what that mean – what that meant?---That there would be no default interest - - -

35

Okay?--- - - - added to the account.

And under the deed NAB agreed to pay some operating costs for your business?---Yes.

40

And was the reason that happened because you didn't have any facilities to pay for operating costs unless the bank was going to accommodate you to some extent?---Yes.

45

Okay. If we move across to 1031, clause 5 imposes a number of obligations on you?---Yes.

Those obligations are primarily set out in (b). By 1 March you agreed to commence marketing for sale either Limbri or Oakvale?---Yes.

5 And you were to exchange a contract for the sale of whichever one you chose by 31 May '14?---Yes.

And you were to have sold whichever one you chose by 30 June 2014?---Yes.

10 And this is – this deed is September 2013 when you signed this document?---Yes.

By 30 September – so that's 12 months from the date of this deed – you had to pay out all of your facilities with NAB?---Yes.

15 And by 30 April you had to make a payment of 200,000 net by selling cattle?---Yes.

You had to pay another 200,000 net by 30 May?---Yes.

And then you had to pay 400,000 net by 30 June 2014?---Yes.

20 Did you go to mediation thinking you would have to sell one of your properties?---No. We didn't think we would, but it was mentioned to us that what we may have to - - -

25 Okay?--- - - - negotiate.

And these payment timetables, 200,000 from cattle sales by the end of April, 200,000 by the end of May, and 400,000 by the end of June - - -?---Yes.

30 - - - how realistic did you think that was?---Not very, considering the current conditions of the properties. This was all sort of looking at if there was some wet season, and cattle would fatten.

I see. So do you remember when you went to the mediation in September 2013 what the condition of your cattle was like?---Poor.

35 And how does – how do cattle sales work? If you sell into an abattoir, are you paid immediately upon delivery?---No, no.

40 How – what are the payment terms for selling into an abattoir generally?---Most – most undertake that it is 14 working days - - -

Okay?--- - - - from the time they get killed.

45 So if you're selling into the abattoir – you have to get the cattle from – they're all at Oakvale by now, I think?---Yes.

Or just about all at Oakvale. You have got to get them from Oakvale to Townsville?---Yes.

You do that by putting them on a truck?---Yes.

5

And did you say 14 days after delivery or 14 days after slaughter that - - -?---14 days after slaughter.

10 Okay. And does slaughter happen pretty quickly?---Usually it does, yes. Usually within a few days.

And what about if you put them on a ship for live export?---You are paid when the ship sails. Same again, 14 days after – depending on your contract, but most times 14 days after the ship sails.

15

Okay. So you needed to pay 200, 200 and 400, all net. So you needed to pay a net 800,000 - - -?---Yes.

- - - from cattle sales?---Yes.

20

How many cattle do you need to sell to get a net 800?---You would – at that stage, good condition cattle you were getting around about \$10,000 for a deck load of cattle, which ideally, weight wise, would be 20, 32 head.

25 A deck is how many you can fit on the back of a truck?---Yes.

Okay. And so how many is in a deck depends on how big the cattle are - - -?---Grown – grown cattle, 20 a deck. 32, 34, export size cattle.

30 So how many deck of cattle do you think you needed to sell to get 800,000 net, do you think?---80 decks.

80 decks. Now, at the mediation, did you ever suggest that this plan was unlikely?---Yes.

35

Did you think there was a chance it might work if you got some rain?---It would have had to have been a super year. If – if that was – that plan was to come into effect.

40 Now, did you have some time to consider the deed before you signed it?---No.

Okay. Did you have an idea at this time what Limbri was worth?---It would only have been – would only have been worth as much as someone wanted to pay for a property with no grass on it.

45

Does that mean not as high value as you would have paid for it?---Yes – yes.

Okay. And what about Oakvale? It wasn't quite as dry at this point, I think?---It wasn't quite as dry, but it was - - -

5 Had there been many - - -?--- - - - getting dry.

- - - sales in either region recently when you went to the mediation that you can recall?---At that time, no.

10 Okay. So is it fair to say you didn't have a firm view about what either property was worth?---Yes.

But did you have an idea of what it was worth in a good season?---Yes. Yes.

15 Okay. There is in this deed – in annexure A, which is 1038, some values ascribed to Limbri and Oakvale. It's that second column Assets. If that could be popped out, perhaps. Perfect. Thank you. Can you see there: assets Limbri, 28,213 acres at 120 an acre, 3.385 million, Oakvale 40,524 acres, \$86 an acre?---Yes.

20 Does that strike you as about right?---If – if it was a good season, yes, it would have.

So you don't think that price is the price in the – likely to be obtained for the properties if you sold them at the time - - -?---At that time.

25 - - - you had the mediation?---No.

Okay. Now, you signed this towards the end of the day, did you, the deed?---Yes.

And did you stay in Townsville that night?---No.

30 Straight back to Oakvale?---Oakvale, yes.

All right. And how did you feel after the mediation?---Very tense. Very tense.

35 And how was Ken?---Worse. Well, more tense than I was.

You didn't feel some relief at having done a deal with the bank?---No.

40 All right. When did you decide which property you would sell?---While we were driving home we sort of thought about things a little. Didn't really come to some sort of agreement until a few days later.

45 And it says it in the letter you wrote to NAB earlier on, but in a passage I didn't read, at that time, at least, when you went to NAB, you were living on Limbri and Ken was at Oakvale?---Yes.

Is that right?---Yes.

And on weekends you would go up to Oakvale?---Yes.

And was that the same in 2013 when you signed - - -?---Yes.

5 - - - the deed?---Yes.

You were – you were managing and running Limbri, he was managing and running Oakvale?---Yes.

10 Okay. So a couple of days later you agreed which one you would sell?---Yes.

And what did you decide?---That we would market Limbri.

Okay. And did you list that property for sale?---Yes, we did.

15

And who did you do that with?---With Andrew Jensen Real Estate in Charters Towers.

20 Did you have a discussion with Mr Jensen or one of his staff when you listed it for sale?---Yes.

And do you remember who it was with?---With Mr Jensen.

25 And what were his views at the time?---That it would be highly unlikely to sell at this time because of the dry conditions.

Okay. And why did you decide Limbri and not Oakvale?---Because we – we breed cattle, and Limbri was more suited to fattening.

30 We saw that the deed – that document can come down now, thank you. We saw that the deed required you to make that first \$200,000 payment by the end of April - - -?---Yes.

35 - - - 2014. Did Ken have an accident in April 2014?---Yes.

What happened to him?---He was hit by a cow from behind, and ended up in hospital for two weeks with a long recovery period after that.

40 What injuries did he sustain?---Broken ribs and a punctured lung.

And how did that accident happen?---Loading cattle for sale.

All right. At?---Oakvale.

45 And were you there when it happened?---Yes.

Right. So you were both loading cattle into a truck - - -?---Yes.

- - - to sell it. And do you remember when in April that was?---I think it was early April.

5 Okay. And Ken went to hospital. Where is your nearest hospital?---Charters Towers.

Okay. You probably don't get an ambulance to come to Oakvale from Charters Towers?---No, no.

10 How did he get there?---My son took him to hospital. We didn't think the – the injuries were as serious as they were.

Now, that was April 2014. What was the rest of 2014 like on Limbri?---It got dryer. It was - - -

15 And what about at Oakvale?---Same again, dryer.

20 By the end of June 2014 you were supposed to have paid NAB \$800,000. Do you know how much you managed to pay them?---Not very much at all. Not that much, anyway.

Could you guess? Or do you just have no idea?---I think there was like 20 or \$30,000.

25 Okay. You hadn't sold Limbri by that point, by June 2014?---No.

Is that because you just hadn't found a buyer?---Yes. It was quite – quite dry then.

30 And did Oakvale eventually go into drought?---Yes.

And when did that happen?---2015.

Okay. And was 2014 generally dry for Oakvale?---Yes.

35 Okay. So by the end of 2014 you had not repaid the 800,000 that you were supposed to pay under the deed of forbearance, and though you had listed Limbri for sale you hadn't managed to get a contract for anyone to buy it, let alone complete the contract; is that right?---That's correct.

40 So you were in pretty serious default of your obligations - - -?---Yes.

- - - under the deed by mid-2014 and the end of 2014?---Yes.

45 In April 2015 you sought an extension from the NAB of the terms of the deed of forbearance?---Yes.

Do you recall that?---Yes.

Did you do that, or did your financial counsellor do that?---Financial counsellor did that.

5 Okay. Can I show you a document. It's NAB.005.451.2196. Now, you mentioned earlier that your financial counsellor was John Swain?---Yes.

But this is a letter from Rachel Bock. Did you get a different financial counsellor at some point?---Yes. John Swain retired. And Rachel was her – was his replacement.

10 And did you speak with Rachel before she sent this letter?---Yes.

All right. And she sent this letter having had a discussion with you?---Yes.

And she says:

15

*I've been instructed by Kenneth and Deborah Smith to request a variation of the forbearance deed under section 2. The clients request you extend the timing for the sale of the property to 30 April 2015 based on the following: Limbri and Oakvale could not be sold to its best advantage if sold in the present drought conditions; due to poor market conditions, Longreach cattle sales (closest market for sale of stock) have only completed three sales to date in 2014.*

20

25 Can you explain what that means?---Longreach usually sells weekly, and because of the dry conditions that were getting worse all over Queensland, that – the sales had been reduced. They just couldn't get the cattle in to - - -

So did you say they usually - - -?--- - - - sale.

30 - - - sell weekly in Longreach. And this is saying 25 July they had had three sales?---Yes.

I see:

35

*Many sales were scheduled and cancelled due to lack of numbers and this has impacted on Ken and Deborah sale schedule. Deborah and Ken's first sale this calendar year was at Roma cattle sales.*

How far is Roma from Oakvale?---It is over 500 kilometres.

40

Continuing:

45

*...on 1 July 2014, 177 head of steers were sold at an average price of 1.15 and a half per kilo. Stock in this condition would usually achieve a sale price of 1.70 a kilo. This is down 32 per cent. Plus increased freight costs were incurred to freight stock the extra distance.*

Do those figures look right?---Yes.

Okay. And then it says:

5           *Development Finance Partners are sourcing refinancing opportunities and expect to have this finalised in the near future.*

This is the first time we've heard of Development Finance Partners?---Yes.

10          Are they people you had arranged to try and find somebody you could refinance the NAB with?---.....

Okay. Do you recall if you received a response to this letter from the NAB?---Yes, we did.

15

Okay. You've exhibited that letter to your statement as exhibit 12. It's NAB.005.451.1282. You can see that this is from Mr Starky, who you have mentioned a few times to Rachel Bock, your financial counsellor, and he says:

20           *Thank you for the attached update. Mr and Mrs Smith are clearly in default of the agreement reached at mediation last year and the bank is not willing to vary the agreement in the manner you have requested. The bank reserves its rights under the deed dated 13 September 2013. Could you please advise when Mr and Mrs Smith expect to have an answer in respect to their application for*  
25           *refinance.*

Did Ms Bock show you this email?---Yes.

Or tell you about it?---Yes.

30

And did you expect that response, or did you think you would get your extension, or was it just a hope?---We were hoping, but we didn't expect it.

Okay. You sent a further email to NAB in October 2014, which is exhibit 13 to your  
35          statement. I will show you that letter. It's NAB.005.451.2309?---Yes.

And you've got the hardcopy there?---Yes.

40          This is you giving a bit of an update to Bruce Starky at NAB. Why did you send this?---To update him on the conditions that we were – yes, we were trying to offload cattle and - - -

Okay?--- - - - try and get some money to them.

45          So you tell them in the first paragraph that you've sent some cattle off to the meatworks, and the proceeds will be paid 14 days from the date of kill?---Yes.

And then you say:

*NLIS readings from these cattle are on the kill sheets.*

5 What's an NLIS reading?---It's a National Livestock Identification System.

All right. And then you say:

10 *As for NLIS readings from cattle on the properties, it is impossible to supply as cattle are not required to be tagged by law until the stock travel. These tags get ripped out on the fences and trees and anything else the cattle rub on. They cost \$4 each, so we don't tag our cattle. They are sold or transported – until they are sold or transported to the other property.*

15 Now, this was because you had been asked by NAB for some information from the National Livestock Index?---Yes.

20 And this is you responding to that. Can you just explain that system and how it works?---You have to – by law now – tag your cattle for transport or when they're shifted off the property, so that any diseases and chemicals that may be in their systems, that are not allowed to be in their systems, can be identified from what property they came from.

25 Okay. And you just buy the tags?---Yes.

And you buy the exact number of tags for the exact number of cattle that you have, or - - -?---No. You've always got extras on hand.

30 Okay. And you need a reader?---If you want to read them, yes, yes.

35 There was some further correspondence that you've annexed – I won't take you to it – in October 2014 and November 2014 where you were trying to come to an arrangement with NAB, if you could. Some of that correspondence is written by Neil Fleming on your behalf. Who was Mr Fleming?---He was a – an adviser that we had sought – sought some help from.

What – was he an accountant or agricultural consultant, or - - -?---I can't remember exactly his qualification. I think he was an accountant.

40 Okay. But he was negotiating on – with the bank on your behalf?---Yes.

For at least part of 2014?---Yes.

45 Okay. But you didn't come to any arrangement?---No.

Okay. So then by early 2015 had you had any rain on Limbri?---No.

And what about Oakvale?---It was getting worse.

All right. Can I show you a document NAB.148.006.1475?---Yes.

5 Is this Limbri?---Yes, that is.

Can you recall when this photograph was taken?---They were taken late 2015.

10 All right. And who took them?---A fellow from – I think Ray White Rural in  
Townsville.

And he had been sent by the bank?---Yes.

15 And what we're looking at here, is that land that you would normally keep cattle  
on?---Yes.

Okay. And let me show you another photograph. It's NAB.148.006 – the first  
document is 1467, but I want to go to 1473. Is this also Limbri?---Yes.

20 And this was taken at the same time?---Yes.

And there's no cattle in either picture, and that's because you've destocked Limbri  
and they're all at Oakvale?---Yes. Yes.

25 Okay. Can we now go to NAB.148.006.1474. This is Oakvale?---That is, yes.

And was this taken at the same time?---Yes.

30 Okay. And was it taken by the same person?---I – I think so, yes.

Okay. Now can we go to NAB.148.006.1467 at 1470. Where's this?---Oakvale.

And this was taken at the same time by the same person?---Yes.

35 All right. Could we go to – could we go to 1472. These are your cattle?---Yes, they  
are.

On Oakvale?---Yes.

40 At the same time?---Yes.

This photograph taken by the same man?---I presume so, yes.

45 Okay. And if we could go to 1469, please. Could you describe the condition of  
these cattle?---Very poor.

And they're eating some hay there. By this stage, you're trucking in hay, are you?---Yes. Yes.

5 Because there's nothing – or at least not sufficient left at Oakvale for the cattle to eat?---That is correct.

Okay. Did you lose any cattle to the conditions?---Yes.

10 And how do you know that?---There was a fellow lost in the mountains, and there was a search conducted for him, and the pilots and the police had told us that there was hundreds of dead cattle in the gullies, in the – in the high country.

Was – Oakvale is not flat land?---No, it's not. It's quite rough.

15 It's partly flat land. It's also a bit mountainous?---Yes.

20 Okay. So this is 2015. And after this – after the bank sent the gentleman from Ray White in to take the photos, the bank then made some funds available for extra feed for the cattle?---Yes.

Is that right? Okay. So that was 2015. Then what happened in 2016 in Limbri? Did you get any rain?---No.

25 And what about Oakvale?---Very little.

And what happened with NAB?---We haven't – hadn't heard from them. They – they had given us some money, but – yes, communication wasn't very strong.

30 I think that picture can come down now, please. So do you recall whether default interest was being charged at this point?---Yes.

Do you recall when they started charging default interest on your facilities?---Yes. Straight away after the – I'm pretty much sure it was straight after the mediation.

35 So, if that's right, default interest had been running for a few years by this point?---Yes.

40 And Limbri is still in drought and Oakvale is still in drought, and you can't get a sale away while the land is in drought?---That's correct, yes.

And your cattle are in poor condition?---Yes.

So that's 2016. Then what about 2017? Any rain at Limbri?---No.

45 What about Oakvale?---Very little.

And what about contact with NAB? Any attempt by you to try and rearrange the facilities or any attempt by them?---No. We – still the properties were not in a position to sell.

5 Would you accept that sometimes you've been a little bit hard for the bank to get in contact with?---Only to the fact that we were probably working from daylight till dark, and long after, and long before.

10 All right. Now, most recently – in I think January this year, NAB wrote to you again?---Yes.

I will show you that letter. It's NAB.148.025.4676. This is exhibit 15 to your statement. Do you recall this letter from earlier this year?---Yes, I do.

15 And that letter could just be made a little bit larger. It says:

*It has been some time since we attended mediation in September 2013. We now – we are now intending to invite you in early 2018 to again use the mediation process to try and agree a way to repay your debt to NAB.*

20

There is then some discussion about cash flow presented at the 2013 mediation, and the agreement that was reached there, your obligations under the agreement. And they say in the third paragraph:

25 *We acknowledge the effort you made to continue to make some payments to us through to June 2015 and that during this period your properties will have been impacted by drought. We also understand that you have sought assistance from a number of parties to try to find a solution to your financial problems.*

30

Now, it is true you had sought assistance from a number of parties. You had two financial counsellors?---Yes.

35 At least for the farm debt mediation, but not beyond, you had Legal Aid?---Yes.

And then you had Mr Fleming, who mention was made of?---Yes.

40 And you had used some other people as well to try and either do a deal with NAB or get a refinance or both?---Yes, yes.

Okay. Now, what did you think when you got this letter?---We – we thought that, yes, the inevitable has happened, and we don't know what's going to happen now.

45 Have you responded to this letter?---No, we have not.

And why haven't you?---Because, not too long ago, Debt Mediation Act changed and we did not think we were eligible because we had been to mediation before.

Right. You thought that it wasn't necessary for the bank to have to have another mediation to enforce its securities, because of your September 2013 mediation; is that what you're saying?---Yes. Yes.

5 Okay. Even if that's true, though, that wouldn't stop you being able to talk to the bank if you wanted to talk to the bank?---No. I guess not, no.

Is any part of your reluctance that you found the process a little disconcerting the first time around?---It was, yes. Yes.

10

Are you thinking about responding to this letter?---Yes.

And have you spoken to Ken about it?---We have spoken, yes.

15 Okay. And does he have a view about whether you should go to mediation or not?---Yes. Yes. He – he doesn't want to - - -

Yes?--- - - - because of the – what we've found out about the Act – the new Act that had come in - - -

20

Okay - - -?--- - - - regarding debt mediation.

All right. When was the last time you had decent rain on Limbri?---The last time was 2010, 2010/2011 wet season.

25

And Oakvale was a bit later than that?---Yes.

When was – when did you get rain on Oakvale – decent rain?---2012/2013 was the last reasonable year that I can remember.

30

Can you recall anybody from the bank at any point speaking to you about hardship arrangements?---No.

Do you recall speaking with somebody from the bank called Dale McDowall?---No.

35

What about Grant Bloomfield?---No.

Okay. What's the condition of Limbri like now?---It has recovered a little, because we have had a half an average wet season, but the grass is very thin at this stage.

40

After you've had drought for a few years, do you need – do you need a better than average wet season to get back, or will an average wet season be enough to get the land regenerated?---You – you need as much years of average seasons at least as – as – as you have had drought. So we've had five years of drought; we need five average seasons to be fully recovered.

45

I see. How has Ken found the last five years?---Very difficult. We've had to work very hard to keep our cattle alive, or keep some of our cattle alive, so that we have something at the end of the drought to continue on with.

5 And how have you found the last five years?---Very stressful.

You acknowledge that you've got significant debt to the bank?---Yes. Yes.

10 So what do you want to do?---We would – we would like to still sell one of the properties to clear the debt, and make way for some refinancing if we need be.

Do you want to stay on the land?---Yes.

15 Do you want to keep Oakvale, if you can?---Yes.

All right. Would you let the bank sell Limbri if they could find somebody to buy it?---If they could find someone to buy it at a – a decent price.

20 And you said earlier that you had been a grazier since 1985. Have you done anything else?---No. I – I don't have any formal qualifications apart from a truck licence.

25 All right. And have either of your children expressed any view on wanting to work on the farm at some point?---Yes. They both love the – love the land, and – and the stock.

Is there a chance your son would come back from the mines at some point?---Yes.

30 All right. I have no further questions, Commissioner.

THE COMMISSIONER: Thank you, Mr Costello. Mr Thomas.

MR THOMAS: No questions, Commissioner.

35 THE COMMISSIONER: Thank you. Thank you very much, Mrs Smith. You may step down. Thank you.

40 <THE WITNESS WITHDREW [12.35 pm]

THE COMMISSIONER: Yes, Mr Costello.

45 MR COSTELLO: Commissioner, the next witness is Mr McNaughton from National Australia Bank.

THE COMMISSIONER: Yes, Mr Thomas.

MR THOMAS: Your Honour, I expect Mr McNaughton will be outside. He will be with us immediately.

5 THE COMMISSIONER: I am trying to get out of the habit of saying he's outside the court. He's outside the room.

MR THOMAS: Indeed. Indeed, Commissioner.

10 THE COMMISSIONER: Old habits die very hard, Mr Thomas.

MR THOMAS: They do indeed.

15 <ROSS McNAUGHTON, ON FORMER AFFIRMATION [12.36 pm]

<EXAMINATION-IN-CHIEF BY MR THOMAS

20 THE COMMISSIONER: You were sworn or affirmed last time we were here – well, not here. Last time in the Commission, I think. Isn't that right, Mr Thomas? So that – the promises then made continue. So if you would be good enough to sit down, Mr McNaughton. Yes, Mr Thomas.

25 MR THOMAS: Commissioner.

THE COMMISSIONER: I will just let the person from your instructors assemble all the papers that - - -

30 MR THOMAS: I'm grateful, Commissioner.

THE COMMISSIONER: - - - have been assembled. Yes, Mr Thomas.

35 MR THOMAS: Your full name is Ross Hugh McNaughton?---Yes, it is.

And your business address is 500 Bourke Street, Melbourne?---Yes, it is.

40 And your current position is general manager, strategic business services, National Australia Bank Limited?---Yes, it is.

Now, Mr McNaughton, have you received a summons to appear at this round of hearings of the Commission?---Yes, I have.

45 Do you have the original of that summons with you in the witness box?---I do, yes.

I tender the summons, Commissioner.

THE COMMISSIONER: Exhibit 4.111, summons to Mr McNaughton.

**EXHIBIT #4.111 SUMMONS TO MR MCNAUGHTON**

5

MR THOMAS: Now, Mr McNaughton, you have prepared two witness statements for this round of hearings?---Yes, I have.

10 The first of those statements is dated 18 June 2018?---Yes, that's correct.

And do you have the original of that statement with you?---Yes, I do.

15 Now, I understand you wish to make one correction to that statement?---Yes, please.

And you've made that amendment in handwriting on the statement?---Yes, I have.

20 Can I direct your attention to paragraph 113 of that statement. Do you have that?---I do, yes.

And you wish to correct the word "fixed" to "flexible"?---Yes, I do.

25 Can you please initial the change in the margin. With that change, are the contents of that statement true and correct?---Yes, they are.

Commissioner, I tender that statement and its exhibit.

30 THE COMMISSIONER: Exhibit 4.112, the witness statement of Mr McNaughton, 18 June '18 with exhibits.

**EXHIBIT #4.112 WITNESS STATEMENT OF MR MCNAUGHTON WITH EXHIBITS DATED 18/06/2018**

35

MR THOMAS: Now, Mr McNaughton, your second statement in this round of hearings is dated 25 June 2018?---Yes, it is.

40 Do you have the original of that statement with you?---I do, yes.

And are the contents of that statement true and correct?---Yes, they are.

I tender that statement, Commissioner.

45 THE COMMISSIONER: Exhibit 4.113, supplementary statement of Mr McNaughton, 25 June '18.

**EXHIBIT #4.113 SUPPLEMENTARY STATEMENT OF MR  
MCNAUGHTON**

5 MR THOMAS: If the Commission pleases.

THE COMMISSIONER: Thank you, Mr Thomas. Yes, Mr Costello.

10 <**CROSS-EXAMINATION BY MR COSTELLO** [12.39 pm]

MR COSTELLO: Mr McNaughton, you're the head of strategic businesses services at NAB?---Yes, I am.

15 And strategic business services is a euphemism for distressed or defaulted business loans; is that right?---Yes, it is.

That's the work of your unit?---Yes, it is.

20 And you've been in that role for a little over 12 months?---Yes, that's correct.

Before that you were the managing director of NAB UK commercial real estate?---In London, yes.

25 In London. Is that an insolvency related function?---No, it's not.

Okay. Had you been in other insolvency related functions before you took your current role?---Yes, I had.

30 All right. And were they in Australia or in the UK?---In the UK.

Okay. You have 80 bankers in your team, and they're most commonly described as impaired asset managers; is that right?---Yes, that's correct.

35 Okay. So an impaired asset manager is a banker who's dealing with a distressed loan?---Yes, that's right.

Okay. And your team includes agri specialists?---Yes, it does.

40 And how does one become an agri specialist impaired asset manager?---Generally, that's through previous involvement with agriculture and banking.

45 Writing loans, for example, to farmers?---Yes, or – or in credit function.

Or in credit. Okay. And are the agri specialists organised into a special team within your team? A sub-team of SBS – if I can call strategic business services SBS?---Yes, that's correct.

5 Okay. And there are 10 agri specialist insolvent – impaired asset managers within that team; is that right?---Yes, that's correct.

And is that team responsible for handling all of NABs distressed loan portfolio for agricultural customers?---The majority of them. There are some which – which  
10 aren't, but generally, all up to – well, farm gate would be managed in SBS by one of those – the agri specialised team.

All right. And that's the team that currently has Mr and Mrs Smith's file under their supervision?---Yes, that's correct.

15 Okay. Now, NAB has a very significant market share in agribusiness lending; you agree with that?---Yes, I do.

All right. And it has got a particularly high share in Queensland?---Yes, that's  
20 correct.

All right. You provide some figures to the Commission in your statement, which is – your first statement, rather, which is WIT.0001.0069.0001. And if we could go to paragraph 21, which is on the seventh numbered page. Could that table be blown up,  
25 please. This is the total number of agricultural customers for NAB for each year since 2008, for the year ending 30 June Australia-wide; is that right?---Yes, that's correct.

And so the numbers have been fairly static, but almost always at or about 20,000  
30 agricultural customers?---Yes, that's correct.

And then at paragraph 18 of your statement you give some figures about rural branches, and rural bank managers. This table on the screen now is the number of branch managers employed in rural areas, broken down by state and territory – no,  
35 sorry, the one that's on your screen now is the number of branches operating in rural areas broken down by state and territory. And you can see the first column is Queensland, and there's 57. And there's more in Queensland than any other state. And in total at April 2018, NAB has 177 branches operating in rural areas; is that correct?---Yes, that's correct.

40 And then if you move to the table in paragraph 18 on the next page, this is the table that gives the number of branch managers in rural and regional locations broken down by state and territory. You will recall that in 2018 I just pointed out that there were 177 rural branches. Why is it that for 177 rural branches there would be only  
45 120 rural branch managers? Do some people manage more than one branch?---I'm sorry, I don't know the answer to that. I don't have responsibility for the agriculture business book.

Okay. But it's right, isn't it, that when a file comes into your group, an agricultural file, the – as a general proposition at least, the impaired asset manager from SBS will work with the existing relationship manager for the bank customer who's in distress; is that right?---Yes, that's correct.

5

It's not that the file is transferred into your group and the relationship manager ceases to have any involvement in the file?---No, that – yes.

Okay. In August last year APRA brought in a new reporting standard, ARS750. Are you familiar with that?---For the purposes of this, I am familiar with it.

10

You learnt about it because of this statement?---Yes.

All right. It relates to agricultural lending and default. You appreciate that?---That's what I understand, yes.

15

And this was a measure brought in by APRA so that there could be, on the public – well, there could be available to APRA, at least, better data in terms of the size and scope of agricultural lending and the amount of enforcement activity in relation to agricultural loans; is that your understanding?---Yes, it is.

20

All right. Can I take you to your response to APRA, which is NAB.005.488.0001.

THE COMMISSIONER: It's one of the exhibits to Mr McNaughton's statement?

25

MR COSTELLO: It is. It is the fourth tab to exhibit 2 of Mr McNaughton's statement.

THE COMMISSIONER: Yes. Just that if he needs access to it, he has a hardcopy there; is that right?

30

MR COSTELLO: Yes.

THE COMMISSIONER: Tab 4.

35

MR COSTELLO: Tab 4 to your first statement, Mr McNaughton. So, Mr McNaughton, you are no doubt much more proficient at spreadsheets than I am. What I want to understand, from looking at this spreadsheet, is the size of the NABs agricultural lending, and the facility limits available to agricultural customers in different segments. Have you looked at this spreadsheet before now?---Not prior to putting my statement together.

40

Okay. But you had a look at it before you signed your statement, perhaps?---Yes.

It says at the top scale factor, bank's millions of dollars to three decimal places. Can you see that?---Yes, I do.

45

So then – so to take the first cell, by example, it’s New South Wales beef cattle. Applying the scale, what is that number there?---\$756 million.

5 That’s the total outstanding balance - - -?---Yes.

- - - in loans to the NAB relating to beef cattle in New South Wales alone?---Yes.

10 All right. And we can see the equivalent for Queensland. If the operator scrolls down a little.

THE COMMISSIONER: Line 42?

15 MR COSTELLO: Yes. Thank you, Commissioner. Yours doesn’t have numbers there, Mr McNaughton because, like me, you’ve got a PDF version, but it’s the first cell on the second page?---Yes.

So that is the number for beef cattle loans in Queensland. That’s \$2.747 billion, is it?---Sorry, I’m just struggling to follow the number there, sorry.

20 Is the version that you’re looking at, Mr – thank you for that – is the version that you’re looking at, McNaughton – is the version you’re looking at say – instead of 2747, does the version you have in front of you say 2521?---It does, yes.

25 I see. So does mine.

THE COMMISSIONER: Mine doesn’t.

MR COSTELLO: I think - - -

30 THE COMMISSIONER: I win, Mr Costello.

35 MR COSTELLO: ..... say bingo. The reason is that there are two of these. The reporting standard has only been in for one year. You had to produce these figures to APRA for the 2017 year but most banks, NAB included, went back and did the calculation for the 2016 year and provided that to APRA on a voluntary basis. And the one that has been brought up on the screen is, I think, for the earlier year. I can just as easily use that one. The one that’s on the screen is in fact tab 3 – tab 3 to your statement. Can you see there now on the second page the number is the same number as on the screen, 2747?---Yes, I do.

40 So that’s – is that \$2.747 billion worth of beef cattle loans in Queensland that NAB has?---Yes, that’s correct.

45 All right. And then it has got the equivalent numbers for other types of agricultural activity in Queensland down the page, but by far the largest is beef cattle with a total outstanding balance, as I just said, of over 2.7 billion, and the second column there is

total facility limits of 3.36 billion. Then the next column across is total value of loans more than 90 days past due, .073?---Yes.

5 And then the total number of borrowers is the last column, which is 2022 beef cattle borrowers in Queensland with \$2.747 billion worth of outstanding balances on facility limits of \$3.36 billion?---Yes.

10 And would you agree that the amount that is past 90 days due is a very, very small amount compared to the total lending?---Yes, it is.

Do you, in your role as head of SBS, have an understanding of the relative impairments to total loans of different aspects of NABs business? In general terms, I don't want figures?---In general terms, yes, I do.

15 So in general terms you gave evidence in the last hearing block in relation to small business lending. Would you expect that, in relation to general small business lending, the ratio of loan value over 90 days to total lending would be more, less, or about the same than this – Queensland cattle, I am speaking about specifically?---Yes. I – I would expect it to be the same.

20 The same?---Yes.

25 So the percentage of borrowers, if you call past 90 days due as default for the purpose of this exercise, the percentage of borrowers in default and the total value of facilities in default is a very, very small fraction of the total lending of the bank?---Yes, that's correct.

30 All right. Otherwise you would need a lot more than 80 staff in your team. You've made some observations about that data in paragraph 25 of your statement. If that could come back up. That's the WIT.0001.00069 – no, sorry, 0069 – yes, thank you. Paragraph 25 of that document. This is you making some comment on the APRA data?---Yes, that's correct.

35 Is that right?---Yes.

And you say in 25(a):

40 *The data shows, for example, that as at 30 June 2016, in all states and territories, less than half of one per cent of the agricultural borrowers had a loan which was more than 90 days past due, being a total of 62 customers.*

?---Yes.

45 Continuing:

*The highest total value of loans past 90 days due was in New South Wales (14.95 million) followed by Victoria (8 million). And out of the total value of*

*loans past 90 days due, the majority was in the following industries: New South Wales, grain growing and mixed grains, livestock and cotton; Victoria, grain growing and mixed grains, livestock, beef cattle and dairy.*

5 Do you have any idea why those particular market segments in those states have the highest amount of loans past 90 days due?---No, I'm sorry, I don't.

Is that something that your agribusiness specialists within SBS would try and work out, whether there are trends where particular industries are defaulting at higher  
10 rates?---Yes, they would.

Or – they would do that? Their function is not just to manage a file that comes into them, they do look to trends; is that right?---No. If – if they were managing numerous files in the same part of the sector, then I think it would be reasonable to  
15 expect they would say – you would raise that concern.

I see. But this type of interrogation that you've set out at 25, that's not the common practice. That's something you've done for the purpose of preparing this statement; is that right?---Yes, that's correct.

20 Okay. That's fine. Do you think that – you're a banker that's worked in the – I don't mean this pejoratively – the sales side and the – now the bad debt side of the business. Do you think that less than .5 per cent of agricultural borrowers with a loan more than 90 days past due is consistent with default rates in other areas of the  
25 business?---I'm – I'm sorry, I don't know the answer to that.

All right. You give the number of agribusiness lenders – sorry, agribusiness clients referred to SBS each year in your statement at paragraph 30 in a table from 2008 to 2017. This is on page 11 of that – yes, there it is. Can see the peak in that 10 year  
30 cycle is 2013 at 154, and in the last year that you've given figures for, 95 clients referred to SBS?---Yes.

And so these – these files – the 95 new files that need to be managed by the 10 agribusiness specialists that sit within your team are in addition to any files that  
35 haven't been resolved within the earlier time. So while there has been 95 referrals into your group, it doesn't mean that there would be 95 files for the agribusiness specialist to manage, because they would have existing files as well?---Yes, that's correct.

40 And sometimes – is that – I'm not sure within NAB – is that referred to as churn, the files coming in and then leaving SBS, or do you have your own term for it?---Historically, that's a term that has been used in Australia.

All right. Yes. Okay. And what's the churn rate within SBS generally?---It's  
45 approximately 75 per cent.

Is that resolved within 12 months? Is that what that means, 75 per cent of referrals that come in are resolved within 12 months or does it mean something else?---It's of files that are referred and accepted by SBS, 75 per cent of them are rehabilitated back to the – the performing book, with SBS no longer involved.

5

I see. So they are repatriated back to the business?---Yes.

I see. And do you have an idea of the average time it takes for a file to be repatriated?---No, I'm sorry, I don't.

10

Do you have a feel for whether or not, on average, it would take longer for an agribusiness file to be repatriated than another type of file?---No, I'm sorry, I don't.

You know about Mrs Smith's file from preparing your statement. Is that a file that has been in SBS for an unusually long time?---Yes, I believe so.

15

Would there be many files that sit within SBS for five years or more?---I'm not aware of the specific number of files.

20 But would there be many?---I don't think so.

Do you monitor that? Is the time that a file sits within SBS a relevant metric that you're interested in?---No, it's not.

25 It's not. All right.

THE COMMISSIONER: Is that a point at which to break off - - -

MR COSTELLO: Thank you, Commissioner.

30

THE COMMISSIONER: - - - Mr Costello? 2 pm, is that going to be - - -

MR COSTELLO: Yes. We will finish – we will finish within time if we resume at 2 o'clock.

35

THE COMMISSIONER: Yes. 2 pm, then.

**ADJOURNED**

**[1.00 pm]**

40

**RESUMED**

**[2.00 pm]**

45 THE COMMISSIONER: Yes, Mr Costello.

MR COSTELLO: Mr McNaughton, customers are referred from other parts of the bank to SBS; is that right?---Yes, it is.

5 And SBS is independent from the business side of the bank, and also independent from the credit function of the bank; is that correct?---Yes, it is.

And is SBS obliged to accept a referral?---Yes, insofar as to review a file.

10 But not to – not to assume management of a file?---Correct, yes.

Unless SBS is satisfied of particular matters; is that how it works?---Yes, it is.

15 All right. You mention in your statement at paragraph 39 that an agricultural customer may be referred to SBS through a review of the customer's customer rating system, which is referred to as CRS or ECRS. Could you just explain the ECRS system?---Sorry, the - - -

ECRS?---Yes.

20 What is that a measure of?---It's – it's a measure of the – the customer's credit rating based on a probability of default.

25 And is that a rating given out of 100?---No. So the rating – the rating works as 1 through to 23, and then ECRS 98 and 99, which are credit default ratings.

Did you say 1 to 20?---Sorry, 1 to 23.

1 to 23 - - -?---Yes.

30 - - - are not in default files – files not in default?---Correct.

35 And then 98 and 99, files in default?---So – yes, so 98 is default no loss and 99 is where we've made an assessment that it's in default and the bank is likely to incur a loss.

And there's some reference in some of the documents – and I'm not sure if it's in connection with ECRS or something else, of a rating that's NALS?---Yes.

40 What does that mean?---A non-accrual loan.

Non-accrual loan?---Yes.

And is that necessarily a loan that's 98 or 99?---That would be an ECRS 99.

45 99. And what – so what does it mean, in effect, for something to be NALS? How is that different to ECRS of 99?---It's the same thing, it just means we're no longer taking interest to profit.

No longer taking interest to profit?---Yes.

All right. So you said that files are referred to SBS from other parts of the business. Can I take you to NAB.005.514.0001. This is tab 38 of your first statement, Mr  
5 McNaughton, if you would like to work from the hardcopy. This is a document headed Referral Form for Categorisation. Is this the form that the business unit needs to complete in order to refer a file from the business into SBS?---Yes. It was the form – that version of the form at that time.

10 At that time. And this form is from August 2012 and relates to Mr and Mrs Smith. Can you see that?---Yes, I do.

Okay. And this form has been submitted by who?---By the banker.

15 Is that Drew Rolfe?---Yes. That's - - -

And you see that name on the bottom of the page. All right. And the banker put some comments in the Background and Current Status. And you can see there that he says:

20

*Beef cattle breeding.*

This is in answer to what the business or model – business model and operations are:

25 *Beef cattle breeding. Applicants breed Brahman Cross steers and heifers for the feeder market. Cull cows from operation are sold direct to works for slaughter. They have a dozer, close proximity to Pentland where they can earn up to \$20,000 a month from at that point in time. It's not the main focus of their enterprise, but it's the key to their cash flow.*

30

And then it says:

35 *What has changed: applicants have been unable to get cattle to market due to wet weather conditions. Applicants have been extremely unlucky as they now had to postpone selling weaners through agents, or cows to meatworks, due to wet weather. This has delayed cash flow leading to applicants missing interest due and schedules in their facilities.*

40 So this is the first time that your part of the bank comes into contact with the Smiths; is that correct?---Yes. As I understand it, yes.

And it's then up to somebody within your unit to decide whether or not to assume management of the file?---Yes, that's correct.

45 And do you remember what decision was made in response to this?---That the file should remain with the banker without SBSs involvement.

All right. And why was that decision made?---From my review of it, of the subsequent correspondence, it was because the – there was likely to be future cash flow to rectify the situation.

5 So in that circumstance the file just stays with the relationship manager, and that's the end of SBSs involvement in it; is that correct?---Typically, yes.

Okay. Now, one of SBSs roles is to manage the hardship process for some types of borrowers; is that correct?---Yes, that's correct.

10

And that includes agricultural borrowers?---Yes, that's correct.

And that's because they're a – what's called within NAB a specialised form of banking, specialised business?---Yes.

15

All right. Now, when something comes to SBS like this, that speaks about applicants being unable to get cattle to market due to wet weather conditions and that has got them to the state where they're missing repayments and the banker thinks that it might be necessary to submit the file to the management of SBS because it's turning into a distressed debt, is there any trigger within your group for the borrower to be notified about a hardship process?---Not that I'm aware of.

20

When you say not that you're aware of, do you mean not that you're aware of insofar as 2012 is concerned, or do you mean now or - - -?---In 2012.

25

What about now?---No, I'm not aware that there's a specific requirement for SBS to – to contact the customer specifically on hardship.

Is it likely you would be aware if there was such a requirement?---Yes, I think I would be.

30

All right. Now, even if there's not a requirement, is there any sort of process or direction? It might not be a requirement, but is there some way that it would ordinarily happen that a person in the situation of the Smiths in August 2012, who had been struck by flood and it had affected their business and their ability to service their interest, would be referred to a hardship process?---Yes. It's – I look at that as being the – the – the general requirement of the job of an impaired asset manager is to consider the circumstances that has led through to the referral of the customer to SBS and make an assessment of what the situation is.

35

40

So how common would it be for an agricultural file to come into SBS at NAB without having first been through a hardship process?---I'm sorry, I don't know the answer to that.

45

Does NAB commonly tell borrowers about the hardship process, or is it for borrowers to ascertain that there is one and act on it in their own right?---Again, I'm

not involved with the – with the front book with bankers, so I – I don't know what the processes are there, I'm sorry.

5 But I thought you had just agreed with me that it was your unit's role to conduct the hardship process insofar as it concerned agricultural clients?---Where they've been referred to SBS.

Only where they've been referred to SBS?---Yes.

10 All right. What about in the situation, as we just saw in August, where there has been an attempt to refer but SBS has declined to take the file. Would SBS have any role in the hardship process there?---No, it wouldn't have.

15 All right. So it would then be incumbent upon the client's banker to tell them about the hardship process; is that how it would work?---I'm sorry, I – I don't know.

20 Would you have any expectation that the person within SBS who reviews the referral form would, when declining the file, suggest to the banker in explaining why it has been declined that they might consider referring the client to a hardship process?---I – I don't know the answer to that.

25 Is it fair to say that hardship is a very minor aspect of the SBS – of SBSs role administering the hardship process in respect of those clients to whom it applies is a minor role within your group?---Yes, I think that's true.

30 But wouldn't it also be the case, just by nature of the fact that the clients that are referred to your file are clients in financial distress, that they are most obviously the ones in need of at least consideration of a hardship process?---Sorry. Could you say that again, sorry?

35 It's fine. Isn't it more likely, by reason of the fact that the clients with whom your group deals are clients in financial distress, that they are likely to be clients that would be in need of a hardship process?---Yes. And again the way that, I suppose, I consider that is that by virtue of a – of a customer being referred to SBS means there is some issue in the background where there's – there's likely to be an element of financial stress, and as part of that the impaired asset manager would review the – view the background and review the circumstances to establish what the situation is, and if in their view hardship had – was a feature, then I think they would – they would act appropriately with that.

40 Well, shouldn't that just be part of the mandatory requirements on review of a file coming into SBS? Wouldn't that be the natural and sensible way to deal with hardship in a serious way, is to consider it when you're first considering taking the file into the section of the bank that deals with borrowers in distress?---Yes.

45 But that's not something you're doing now?---Only where the file is referred to SBS.

But not always where the file is referred to SBS, is what I thought your evidence was?---Well, where – where a file – where the file is referred to SBS, we will always follow the same review process, not necessarily with a hardship lens on it. It would be a – a general try to understand what the situation is, and if hardship was  
5 recognised as having occurred, or being – you know, occurring – then I would expect the impaired asset manager to flag it accordingly.

But I think you accepted earlier that it's not – there's no requirement for the impaired asset manager, on reviewing it, to refer or perhaps even consider referring to a  
10 hardship process at the moment. It's not a requirement within your business that that be done?---Sorry, I – I think I've misunderstood your earlier – your earlier question. So when a file comes to SBS we would review the circumstances as to why it has been referred, and as part of that referral, if hardship was identified, then we are required to flag that in our system and then act in accordance with our hardship  
15 policy.

So you are in fact required?---Yes, sorry, I misunderstood.

- - - to flag for hardship. All right. And is that only for files accepted or is it as  
20 happened in August, when a file is reviewed, but you declined to take over management of the file. Is there any flagging process in those circumstances?---No, there aren't.

Right. So that's a gap, isn't it?---Well, to the extent that a file is referred and it was  
25 reviewed, I wouldn't expect the file then to be passed back to the business if hardship was present.

All right. Were you in court for Mrs Smith's evidence?---I wasn't in court, but I saw  
30 the evidence.

You saw. Did you hear her answer that she has not at any stage, to her recollection, been advised of any hardship process by anybody at NAB?---Yes, I did.

And were you surprised to hear that?---No, I'm not.  
35

Why are you not surprised?---I don't necessarily think that, on my review of the file, that the circumstances are hardship.

It was first offered to SBS in August 2012 because they were having trouble  
40 servicing the loan because there had been a flood that prevented them selling cattle. On 1 January 2013, drought was declared in the Flinders Shire Council, where their fattening property Limbri is. And Limbri has been in continuous drought since 1 January 2013, and you don't think that that is a file that warrants even a consideration of hardship?---No. I – I – on my review of the file, I looked at that as  
45 business viability rather than solely as hardship.

Well, what – if five years of drought doesn't invoke hardship, what does?---Yes. I – there are a number of circumstances set out in our – our policy, which had examples, but not exclusively hardship.

5 All right. Can I show you NAB.005.291.0001. Is this the policy that you're referring to?---I'm sorry, can you tell me which tab that is, please?

Well – sorry. Actually, I think this is a version that's not in your tabs. You will have to – there is a version in your tabs?---Okay.

10

And whether or not there's any material difference between this one and the one that's in your tab, I am not sure. But does this document look familiar?---Yes, it does.

15 Okay. Can you tell – I don't think you can tell from the face of the document the dates that this document - - -?---No, I'm sorry, I can't.

That's all right. You've been handed a hardcopy of the document on the screen, have you? All right. This is the policy, at least at some point in time, that applied to your business, the business for which you're responsible within the bank's strategic business services; is that right?---Yes, that's correct.

20

And if you turn to the third page, which is 0004, the second line there says:

25 *Hardship refers to a customer's difficulty in meeting their obligations, which is generally on a temporary basis, after which they are able to resume making repayments as per normal.*

Now, perhaps that's what you had in mind when you said you considered this to be viability, not hardship, because this is no longer a temporary situation; is that what you meant?---In the case of the Smiths, yes.

30

Yes. That wasn't the case in August 2012 when it was first referred to SBS, was it?---No, I don't believe it was.

35

And it wasn't the case later in 2012 when the file was again referred to SBS and SBS assumed the management of the file?---Sorry, what – what wasn't?

All right. Do you remember when SBS took conduct - - -?---Yes.

40

- - - of the file?---I do.

Do you remember that was later in 2012?---I do, yes.

45 Yes. At the time that SBS accepted the referral of the file, you couldn't have said that that was a viability issue, could you, with confidence?---No, I – I – I think it could have been.

Do you think it was?---Yes. I don't know the answer to that, sorry.

All right. It says then, underneath the paragraph I just took you to:

5           *Hardship notice is the act of a customer providing us with information about their situation.*

So that's what a hardship notice is: a customer providing you with information about their situation. Is there any obligation in this document on anybody within SBS to  
10 tell a customer that a hardship process exists?---No, there isn't.

Why isn't there?---I don't know the answer to that, sorry.

Okay. Are you – you are responsible for the administration of this policy; is that  
15 correct?---To the extent it – it's a requirement on SBS, yes.

Well, it's entitled SBS Hardship Procedural. Is there anyone else it could apply to?---No, there isn't.

20 This is exclusively the hardship policy for the part of the bank that you run?---Yes, that's correct.

And are you responsible for the content of it?---Yes, I am.

25 And have you made a conscious decision not to have a requirement in here for a bank officer to tell somebody that a hardship policy exists, or is it something you have just not thought about?---I haven't made that assessment.

Do you think it would be a fair thing to let people know that there is a hardship  
30 policy, just to let them know of the fact that there is a policy that they might be able to avail themselves of some assistance under?---Yes, I think that's something we could do.

All right. And then it says there are some of the more common hardship causes  
35 leading to a referral and it includes, in the second column, natural disasters. And would you class drought as a natural disaster?---In – in my view, yes, it is.

In the way this policy is administered by the bank, is drought considered a natural  
40 disaster?---Yes, I – I don't know the answer to that.

Well, I'm not sure that I can accept that answer. You are the person who is responsible for the unit within the bank that is responsible for administering this policy. It applies exclusively to the unit of the bank that you run. How can you not know the answer to whether or not you and your staff would consider drought to be a  
45 natural disaster within the meaning of this policy?---I consider it to be, in my view. I don't know – yes, I mean I don't know if that's individual views across other people.

Is there just discretion in whoever the person's desk it lands on to decide the hardship application as to how they apply this policy?---No, there isn't.

5 Well, then, how do you get any consistency of an approach to a fairly fundamental question like the one I just asked you: does drought come within natural disaster?---I haven't specifically asked across our agri business managers for their views on drought as being a natural disaster. My view, as I said, is that it is, and I would expect that, when any impaired asset manager does a review, that they consider whether hardship applies.

10 All right. And is it any role of yours to give direction to your staff about this – how this policy applies?---I haven't done that yet.

15 Right. Do you think that's a mistake?---No, I don't.

Why don't you think that's a mistake?---Because I think the – I think the policy is sufficient.

20 Notwithstanding that you were unwilling to give me a definitive answer about whether natural disaster includes drought, you think the policy is sufficient?---Yes, I do.

All right. If we could turn to 0008. See there:

25 *Assisting customers who experience financial hardship is important to the bank as it can help to protect the bank's reputation and retain customers, reduce instances of bankruptcy, reduce bad and doubtful debts, prevent the write-off of bad debts, and comply with our regulatory requirements under our banking licence.*

30 Do you agree that there are good reasons to robustly implement a hardship policy in the bank's own interests?---Yes, I do.

35 And it is one of those circumstances where the robust implementation of a policy in the bank's own interests will ordinarily coincide with the interests of the bank's customer?---Yes.

40 And do you think that you need to do more as a unit within SBS to administer your hardship policy?---No, I don't.

You think that what you're doing at the moment is sufficient?---Yes, I do.

45 Notwithstanding that there's no requirement to even let a customer know that it exists?---Yes, I – I think we have a sufficient policy.

Why do you think it's sufficient to have a policy but not to tell the customer about it? Doesn't it strike you as an odd thing to say?---No, it doesn't.

Why is that?---The impaired asset managers across the business are – are experienced, and there’s a sufficient level of oversight of what they do, when a file reaches SBS, that I have sufficient comfort that, if hardship was present, then it would be considered.

5

And how do you know that? That’s your impression?---That’s my experience and my time in SBS.

10 How many hardship applications does SBS receive each year?---I’m sorry, I don’t know the answer to that.

Would you be able to – do you know how many files SBS receives each year?---I – again, I don’t know that number.

15 Do you know how – you don’t know how many agricultural files you receive each year?---No, I don’t.

I think we - - -

20 MR THOMAS: Can I just indicate, my friend has asked Mr McNaughton about the number of files – agricultural files referred - - -

MR COSTELLO: I’m just - - -

25 MR THOMAS: - - - to SBS .....

MR COSTELLO: I’m just about to take him to it.

30 MR THOMAS: I am grateful to my friend.

MR COSTELLO: You may not be able to recall now, Mr McNaughton, but earlier we spoke about how many agricultural files are referred to your unit each year and we spoke about churn; do you remember that?---I do, but that’s not the number of files referred, that’s the number of files accepted.

35

I see. So you draw a distinction between those where there has been a referral and it has been rejected and those that have been accepted as SBS files?---Yes.

40 Okay. All right. So, for example, in 2017 – the figures in your statement show that in 2017 you accepted 95 agricultural files?---Yes, that’s correct.

Now, would it be fair to say that a number of those files, at least, would be distressed borrowers because of climatic events?---I’m sorry, I don’t know that.

45 How many years have you been in SBS?---I’ve been in Australia since May 2017.

And do you meet, as part of your ordinary work, with the specialised agribusiness team within your group?---Yes, I do.

With the group as a whole or with the leaders?---With the – with the leader.

5

Right. And do they communicate with you about the files that have been accepted into their part of SBS?---Yes, they do.

And do they communicate with you the types of files they're seeing and the reasons they're seeing them coming through?---Yes, they do.

10

And when they're having these conversations with you do they ever express to you anything about drought, flood, pestilence?---Yes. They will talk about general market conditions.

15

So you have a general awareness that there are at least some files that come into SBS – that are there for reason – some agricultural files that come into SBS that are there by reason of, at least in part, a natural disaster?---Yes.

Yes. All right. And – but you don't know how many of those are the subject of an application for hardship relief?---No. I'm sorry, I don't.

20

And you don't know how many of those the customer was told that there is a hardship process that they might avail themselves of?---Yes. Again, I'm sorry, I don't.

25

All right. Thank you. Since you took over the leadership of SBS have you become aware of the farm debt mediation process?---Yes, I have.

You understand that this is a legal requirement in three states that must be adhered to before a bank is capable of enforcing a farm mortgage?---Yes.

30

All right. And would you expect, as a general proposition, that before farm debt mediation proceeds that a client might have been advised of hardship policy?---Sorry, I – I missed - - -

35

Would you expect as a general proposition that before a notice is sent requiring a farm debt mediation that a client would have been made aware of a hardship policy?---I – I'm not aware that – that we would send a notice of – of a hardship policy prior to farm debt mediation, but it would be part of the assessment that the impaired asset manager would make.

40

Okay. But there's no policy, just – I want to be sure - - -?---To notify; correct.

Thank you. The Smiths became agribusiness customers of NAB in 2008, are you aware of that?---Yes, I am.

45

And are you aware of the ban on the live export of cattle to Indonesia that was put in place by the Australian Government in about June 2011?---I'm now aware of it, yes.

Yes. Were you aware of that before this statement?---No, I wasn't.

5

All right. Have you spoken with any of your agribusiness managers – agribusiness impaired asset managers about that aspect of this file, the live – the live export ban?---No, I haven't.

10 Okay. Have you informed yourself in any way about the live export ban, what happened and the effects of it?---Only through reading the file.

Okay. Are you prepared to accept that the live export ban was a very significant shock to the Australian cattle market, but in particular to the Queensland cattle market? You are prepared to accept that?---Yes. And from what I heard from Mrs Smith - - -

15

Yes?--- - - - earlier, yes, I do.

20 And even more particularly, I think, in the North Queensland cattle market. You heard Mrs Smith explain that that had an impact on their business?---Yes, I did.

And, by August 2012, the Smiths were in financial difficulty and that led to the business manager making the first referral into SBS?---Yes.

25

And that was as a result not just of the live export ban, which had created some difficulty for them, but for flooding on one of their two properties which prevented them selling. You're aware of that?---Yes.

30 And that was rejected. But then, in November 2012, there was a further referral made by the same banker and this time it was accepted. Are you familiar with that?---Yes. Could you take me to the document, please?

I can. It's tab 41 of your first statement. It's NAB.005.481.0001. So this is the referral, I think, that was accepted; is that correct?---Yes, it was.

35

Okay. And then if we go to the second page, 0002, and if that last box could just be popped out, please. So on the form there is this section:

40 *Banker's proposal (including likely to be turnaround or recovery file)*

Before we go to the text in the box, could you just explain what is meant to happen here in this form? This is something filled out by the – by the client's frontline banker?---That's correct.

45

And is this where they express their view about what should happen?---Yes, it is.

And that means what should happen – what SBS should do?---It's a recommendation.

5 Right. Okay. And so the recommendation here is retain. What does that mean?---In SBS terms, that the – the client is one that we think can turn around, and ultimately be rehabilitated back to the – the performing book.

Okay. It says there that:

10 *There has been poor account management. Fundamental to the core beef cattle operations appears to remain viable with increased breeder numbers, favourable season and substantial feed reserves.*

15 And then there's some talk of an ATO debt. So this is the banker saying he thinks the business is viable, but it should be managed by SBS?---Yes.

20 And SBS accepted this referral on this occasion. What should the impaired asset manager that comes into possession of a file with a recommendation like this, and the history of the earlier referral that was not accepted, do?---The – the same process of trying to establish the – the circumstances, and ultimately set a strategy of what rehabilitation will look like.

25 And speaking, perhaps more generally than just the Smith file at the moment, what are the sorts of options that an impaired asset manager might look to, to rehabilitate a client in financial distress?---It could be an extension of time, or a relaxation of covenants, or postponement of amortisation.

Okay. This form was dated 5 November 2012. You can see that - - -?---Yes.

30 - - - from the first page. NAB began charging default interest on overdrawn amounts on the overdraft on 1 November 2012. So that is four days before this form was submitted?---Yes.

35 Now, does the imposition of default interest on overdrawn amounts make it more or less likely that the client's file can be rehabilitated?---I think it depends on the individual circumstances.

40 All right. If it's an individual circumstance where cash flow is a current difficulty, would the imposition of a higher rate of interest assist in any way to rehabilitate?---It – yes, it's – it wouldn't assist.

45 At the point this file came into SBS there were a range of options available to the asset manager who took responsibility for the file. Was that – would that asset manager have had authority to stop default interest being charged on the overdrawn amounts?---I – I don't actually know, at that time.

What would happen now?---Now, it would be a decision by one of my direct reports to – to a certain level, depending on the level of debt.

5 You would need a particular level of authority to waive a particular level of interest?---Yes.

10 Because 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. Do you agree with that?---Yes. That – that’s within the – within the authority of the – of the impaired asset manager.

15 It is?---Whether it’s – whether it’s relevant or not depends on the individual circumstances.

Right. But it is within the authority?---Yes.

20 It is at least a theoretical option?---Yes.

You could do that. So one option is to start charging default interest from four days before it goes into SBS. That’s a real option, and it might - - -?---Yes.

25 - - - happen by automatic process, I suspect?---It does.

And then it’s a matter for SBS to determine whether to continue with the default interest. You agree with that?---Yes.

30 It’s only SBS that can waive the default interest?---I don’t actually know whether the – the business could or not, either.

Right. Would it surprise you - - -?---At that time.

35 - - - if a file that’s under management by SBS, a decision like that could be taken by the business?---No, as the files continue to be managed in conjunction between the business and SBS.

40 Right. All right. So one theoretical option, increase the overdraft facility limit. It’s now back in order. And would one consideration in making that decision be whether or not you had adequate security to cover the increased limit?---Firstly, it would be the viability consideration and then, secondary to that, the security.

45 So in this circumstance where the relationship manager has expressed the opinion that it should be retained and it is a viable business, if the relationship manager is right in that opinion, then would it be right that the next question is, if we bring the overdraft back into order by increasing the facility limit, do we have enough security to cover our position?---No. The – the next question to that would be, “Well, if we

increase the facility limit, how does the – how does the facility limit ultimately be restored back to the previous level.”

5 I see. So does that mean security is not a relevant consideration?---No, that it is, but it's not - - -

It is?---It's not the primary consideration.

10 The primary consideration is whether the business is going to bounce back?---Yes.

But I thought you had – I had put the question to you on the basis that the viability assessment recommended by the relationship manager was correct?---But that's not – that's not his decision to make.

15 No, no, I understand that. But my – sorry, let me make it quite clear: that's his recommendation to SBS?---Yes.

20 He has got no decision to make here at all; he just fills out a form to try and refer something to you. It's entirely for you to decide whether or not the file is taken?---Correct.

And he gives you a recommendation, and his recommendation says, “We should retain the client and they've got a viable business”?---Yes.

25 And if he's right in that respect that the business is viable, and the client should be retained, then 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 can 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  
30 headspace to get through – some head room to get through the troubled patch. Do you agree with all of that?---Yes, that's an option.

35 All right. And are you aware of whether or not, after the file was accepted into SBS, the default interest on the overdraft continued to run?---As far as I'm aware, it did.

And has it continued to run since?---Yes. As far as I'm aware, it has.

Since 1 November 2013?---Yes.

40 All right. Just reflecting on that aspect for now, which is only one aspect of the management of the Smiths' file, do you think that with the benefit of hindsight the application of default interest to the overdraft has been to the disadvantage of both the Smiths and the bank?---Yes, I do. And – and I think that's why when we – we ultimately got to farm debt mediation that that matter was addressed.

45 Yes. And is that the appropriate way to address it, to take it to farm debt mediation by serving a notice on the farmer that says that the bank is considering selling the

secured property which happens to be their home?---Not in itself, no, but it – I look at that as part of an overall resolution as to what can happen at farm debt mediation.

5 All right. Before I go further with that, I just want to quickly take you to –  
Commissioner, I haven't tendered the hardship policy. Could I tender that, please.  
It's NAB.005.291.0001.

10 THE COMMISSIONER: Exhibit 4.114, SBS hardship procedural,  
NAB.005.291.0001. Exhibit 4.114.

**EXHIBIT #4.114 SBS HARDSHIP PROCEDURAL (NAB.005.291.0001)**

15 MR COSTELLO: Mr McNaughton, in your first statement to the Commission you  
mentioned prudential standard APS 220?---Yes.

20 Just so you can familiarise yourself, you do that at paragraph 15(c). I just want to  
take you to that document briefly. It's RCD.0022.0005.0001.

MR THOMAS: I can give the witness a copy ..... if that would be - - -

THE COMMISSIONER: Yes. For me or for him or for both?

25 MR THOMAS: If you would like a copy, Commissioner, I can arrange it.

THE COMMISSIONER: No, I've got one on the screen.

30 MR THOMAS: If your Honour pleases.

MR COSTELLO: In paragraph 15(c) of your statement – your first statement, Mr  
McNaughton, you say that your responsibilities involve ensuring that bankers within  
the SBS team comply with this prudential standard?---Yes.

35 Do you remember that?---I do.

All right. And this is a document you would be well familiar with?---I'm familiar  
with the team – my responsibility under it.

40 This is a document which imposes a variety of obligations on authorised deposit  
taking institutions, some of which involve having appropriate credit policies and  
procedures in place within the bank. Do you agree with that?---I do, yes.

45 And it relates, in large part, to impairments?---Yes.

And how impaired loans are identified and managed?---Yes.

And that is the heart of what you do and your team does in SBS?---It's certainly part of it, yes.

5 Yes. And SBS is probably – in some respects, exists within the bank in answer to this prudential standard which requires banks to have specialist people that manage impaired loans?---It's – it's part of – it's part of it.

10 Yes. Are there other prudential standards that you're responsible for?---No, there aren't.

No. All right. If we could go to 0004. See paragraph 7 speaks of:

15 *Credit risk, being the risk of counterparty default, usually represents the single largest risk facing an ADI, and the presence of a well-functioning credit risk management system is therefore fundamental to the safety and soundness of an ADI.*

20 And where it says there a “credit risk management system”, is that what ECRS is?---Yes, it is.

Thank you. And there is a requirement in 8(b) for proper policies and procedures for the identification and appropriate measurement of impaired facilities; see that?---I do, yes.

25 And in (e) for the write-down or write-off of uncollectable facilities; see that?---I do.

Then if we go to 0007, under the heading Recognition of Impaired Facilities, it's a requirement:

30 *...to have policies and procedures to ensure the timely and reliable recognition of impaired facilities incorporating as appropriate the exercise of experienced credit judgment.*

35 And the – it might be that the exercise of experienced credit judgment is where SBS comes in?---Yes.

And then in 24 there is recognition of what an impaired facility is:

40 *Where there is doubt over the timely collection of the full amount of cash flows contracted to be received by the ADI.*

?---Yes.

45 So wherever there is doubt that what has been contracted to be paid to the bank will be paid, the facility could be considered impaired?---Yes.

And then if we go to 27 on the next page – actually, perhaps if we go to 26 first, you will see there’s some greater definition of impairment. So it points to some particular events that would constitute doubt about whether or not the bank is going to receive its contractual entitlements, and one is the facility is 90 days past due.

5 And that’s why, in the APRA report, the spreadsheets that I took you to earlier, one of the columns refers to past 90 days due?---Yes, that’s correct.

That is the – that is a bright line signal for impairment?---Yes.

10 All right. Then in 27:

*Where a facility has been identified as impaired an ADI must raise provisions.*

15 Could you explain the concept of raising provisions?---When – when impaired asset manager has a – has a file where it has gone 90 days past due, and future payment is in doubt, then they should assess the future cash flows and security position to consider whether the – whether the bank is likely to – the bank’s position is likely to result in a loss.

20 All right. And what’s the consequence of classifying a file as being impaired insofar as the bank’s cost of capital is concerned?---My understanding is that we would hold additional capital.

25 And the fact of the bank holding additional capital, is that a cost to the bank’s business?---I – I don’t know the answer to that, sorry.

Right. 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.

30 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  
35 comply with the terms.

I see. Given that, do you think that charging default interest for an extended period, in circumstances where there is plainly incapacity to pay it, is perverse?---No, I don’t.

40 How could it possibly serve as an incentive to pay when there is no capacity to pay?---I – I think in situations such as the Smiths, the way that my experience has been the bank has tried to deal with that is through – through farm debt mediation, which would result in all or a large element of the default interest over that long  
45 period of time being waived or rebated.

All right. Well, I will come to the farm debt mediation in a moment. But before I do that, you explain in your statement – or you set out rather, in your statement, the default interest that has been charged to the Smiths’ account. Do you remember doing that?---Yes, I do.

5

All right. And do you have a recollection of the amount of default interest they’ve been charged so far?---Can you just take me to that part, please?

10 Yes. Do you – I will put it up on the screen. It’s WIT.0001.0069.0001. And it’s at 0041. So, Mr McNaughton, if you’re working off the hardcopy, this relevantly starts at paragraph 158. This is the explanation of the Smiths’ current facilities. There’s an earlier explanation about overdraft and when it – sorry, default interest, and when it started being charged on the two facilities. I’ve already told you that it was 1 November 2012 that the overdraft – default interest was applied to the excess of the  
15 overdraft. It was March 2013 when the \$3.1 million facility started having default interest applied to it. That’s from - - -?---Yes.

20 - - - 147 of your statement. And then you set out here, on this page and the next page in the table, the current balances and interest rates. And you can see on the overdraft NAB is charging 10.92 per cent on balances up to 530. 530,000 is the limit that had been approved in 2012 that they went into excess of?---Yes.

25 And the facility limit on the overdraft has never been changed at any point since then. So it remains at 530, and is – what I understand this to mean that 10.92 is just the standard rate of interest, and that is the rate that is applied to the balance within the limit. So the full 530. Is that what you understand that to mean, 10.92 per cent?---Yes, it is.

30 And then on the balance over the 530, NAB is charging 18.07 per cent?---Yes.

And the current balance of that overdraft facility in consequence is now \$1.875 million?---Yes, it is.

35 And then there is the business markets facility, which is over the page on the hardcopy. And it doesn’t have a limit at the moment. The reason for that is it has expired?---Yes.

40 So there is no available limit. And 13.27 per cent is being charged on the entire balance of that – of that facility?---Yes, that’s correct.

And that has led to a balance in that facility of just under \$6 million; is that correct?---Yes, that’s correct.

45 And this is the facility that I had referred to with Mrs Smith in her evidence as being the \$3.1 million facility?---Yes, that’s correct.

That's what the previous limit was: \$3.1 million. Is that – do you agree with that?---Yes.

5 And as a consequence of the interest that has been applied to that, that's now a touch under \$6 million. This file has been managed by SBS since November 2012. Do you consider it prudent and in the interests of the bank for interest to continue to accrue at those rates on those facilities?---No, I don't consider it to be in the interests of the bank.

10 Why not?---Because it's – the – the loan and the facilities have been in long-term default, and we sought previously to resolve the situation with Mr and Mrs Smit and, at some future point in time, still need to resolve this situation.

15 Do you agree that in the circumstances that have presented themselves to Mr and Mrs Smith, some of which are in their control and many of which are not, that there is just abject unfairness in interest running for so long at such high rates?---You know, I think – as I have set out in my answer to question 31 – this – this generally is a difficult situation.

20 Yes?---Even by SBS standards. And my – my hope and expectation is still that we will resolve the situation with Mr and Mrs Smith along the same lines as the previous farm debt mediation, which will look to address the previous default interest, and that which has occurred since then, whilst – whilst giving adequate time.

25 Do you accept that farmers in long-term drought situations are under heightened degrees of stress as a consequence of the situation they find themselves in?---Yes, I do.

30 Do you accept that proposition? Do you think that in circumstances where facilities are in default and drought continues for the extraordinary period that it has continued in this case, that the continued imposition of default interest on the facilities places a further burden on the farmers?---Yes, it could do.

35 Do you think it could add to their stress?---Yes, I think it could.

And do you think that one reaction to stress might be disengagement?---I'm – I'm sure that – I'm sure that could occur.

40 Would it surprise you if a person in this situation with that – now that level of indebtedness on facilities that were, in 2012, 850,000-odd and \$3.1 million, might find those figures of 8.175 million and 5.937 million just completely overwhelming?---Yes, I – I – I think they could. And, you know, as I said previously – and I tried to cover in my statement, the situation is – is really difficult and I think, having heard Mrs Smith talk earlier, I think it's confronting in terms of the stress that  
45 she ha – she has faced. I also think that, in terms of the communication with Mrs Smith in my review, it could have been more proactive for the bank – by the bank. But also there's a balancing there where we know the drought continues, and we

don't want to harass Mrs Smith by – and Mr Smith by writing to them frequently. So there is a balance in – in the approach we try and take.

5 You've reviewed the forbearance deed that was agreed to at the farm debt mediation?---Yes, I have.

10 All right. And you know that that deed required a number of things of the Smiths, one of which was to sell one of the two properties of their choice?---Sorry, could you take me to the - - -

I can. It is NAB.005.451.1023. This is the document on the screen?---Sorry, which tab is that one, please?

15 I'm not sure – sorry, I have taken you to the document on the screen that's in Mrs Smith's statement, but it's tab 60 of your statement as well. You can work from that. It's precisely the same document. So you've reviewed this document in preparation to give evidence today?---Yes, I have.

20 And I was saying to you that there are a number of obligations on the Smiths. Those obligations are set out primarily in clause 5, which is 1031 of the numbering in the top right-hand corner, or page 8 at the bottom of the deed. And you can see there that they had to, by 1 March, commence marketing for sale either Limbri or Oakvale. By 31 May they needed to have a contract for whichever they chose and, by 30 June, they had to have completed the sale of the property?---Yes.

25 Now do you accept that, as things transpired, it has been impossible for them to comply with those obligations?---Yes, I do.

30 And they had other obligations, including to make repayments within time, and those repayments were not made. You understand that?---Yes, I do.

There was some small amount paid, but nothing like the amount that was required by this deed?---Correct.

35 And you accept that Mrs – you understand that Mrs Smith says it was simply impossible for them to make those payments?---I don't think that's what she said earlier.

40 What did you understand her evidence to be?---Well, I – I understood it as unless there was a good season.

Sorry, I don't mean at the time of signing this, I mean as things transpired?---Yes, sorry, yes.

45 Yes. And do you accept that?---Yes, I do.

You accept that that was the fact?---Yes.

So from – within eight months, nine months of this deal being struck, circumstances had transpired that made it impossible for the Smiths to fulfil the core of their obligations under the deed; you've accepted that?---Yes.

5 Now, as things continued to transpire, it became even less likely that they would be able to comply, didn't it, because the drought continued?---Yes, it did.

For far longer than anybody would have foreseen?---Yes.

10 So my question now is what should SBS do in those circumstances? By the middle of 2014 it was clear that Limbri could not be sold and Oakvale was struggling as well. Didn't something need to be done at that point?---Well, from my review of the file, we – we waited, and waited, hoping that it would rain. And if that had occurred, again from my review, then it would have been the intention to reengage with – with  
15 Mr and Mrs Smith.

Do you appreciate that there's a material difference, at least so far as the Smiths are concerned, between waiting and applying default interest and waiting and not applying default interest?---Yes, I understand that.  
20

And do you think that it would have been in the interests of the bank if it had stopped applying default interest in 2014?---In – sorry, in what sense?

In the sense that it – as I understand it, the bank agreed by the deed of forbearance that default interest would be rebated, in effect?---Yes.  
25

Subject to compliance by the Smiths with their obligations?---Yes.

Nature frustrated the ability of the Smiths to comply with their obligations?---Yes .....  
30

You've accepted that. Wasn't the fair thing to do in those circumstances not to impose default interest in circumstances where it was completely outside the control of the Smiths?---That – that, I think, is – is where – where we were always likely to get back to, in the sense that we entered the initial forbearance deed that would do as  
35 you described, and when the – when the weather broke, my review of the file suggested to me that we would – we would still aim to get back to the same point.

That's something known to you, but not known to them, isn't it?---That's correct.

40 So while you are aware of that, they're on the farm with cattle they can barely feed and default interest running at very high rates, aren't they?---Yes.

Do you think that the community would have an expectation on the bank in those circumstances to communicate what you know to the Smiths frankly and fairly?---I think – as I set out in my statement, I think we could have been more proactive in our  
45 communication, but it's a balance between writing to the Smiths regularly, when we know it's still in drought and we know the situation is, to the best of our knowledge,

not changed, and – and, you know, communicating that default interest continues to accrue, but we – you know, we wish to reengage in a farm debt mediation.

5 In your statement, what you're referring to is paragraphs 174 and 175, I think. You say:

10 *NAB could have potentially done more in its communications with the Smiths in the period after their default under the forbearance deed in one respect: I think NAB could have been more proactive in taking steps to ensure that the Smiths and their advisers were conscious of the practical consequences to the Smiths should their default under their facilities continue, particularly with respect to the accrual of what is now substantial default interest.*

15 Is that the paragraph that you're referring to?---Yes, it is.

My question to you is not, "Do you think you should have communicated to the Smiths better that you are charging default interest?" Which seems to be the point that you're getting to there. My point is, in circumstances where you have said that you expected the bank would ultimately waive it at a further farm debt mediation, shouldn't you have just stopped charging it and told them that?---I think it always had to be part of the overall resolution to the situation.

20 But what good is served from continuing to apply default interest that will almost certainly not be paid, and adding to the stress and burden of people that are already subsisting in a horribly difficult situation as things stand?---Yes. I – I don't think there is any – any good in that.

25 THE COMMISSIONER: You speak, Mr McNaughton, of sending them letters. Where is the nearest branch?---Hughenden, Commissioner.

30 Would it be possible for the manager to go out and see them with a set of instructions in his/her back pocket about what he or she is to tell them?---Yes, that would be possible.

35 MR COSTELLO: In that connection, Mr McNaughton, towards the end of her evidence I asked Mrs Smith if she was aware of the names of two NAB officers. Did you hear me ask her that?---I didn't actually, because the internet cut out when I was watching.

40 We would prefer if you wouldn't say that when you're in the witness box.

THE COMMISSIONER: Or at all. We would prefer if you didn't have the occasion to say it.

45 MR COSTELLO: We're trying to fix that. I asked Mrs Smith if she was aware of – or had spoken to Dale McDowall or Grant Bloomfield. Are they names that you can recall putting into your statement?---They are, yes.

Yes. They are the names that you set out in paragraph 66. Perhaps that paragraph could be brought up in Mr ..... statement. It's WIT.0001.0069.0001. And it's the table on paragraph 66, which is on the 0024 is the relevant part of the table – sorry, 23. Sorry, it is one earlier than that again. Paragraph 66. Thank you. Can you see there, this is a table that is in your statement in answer to a question. Question 13 was:

10                    *Who was the Smiths' relationship manager when they first became clients of the bank?*

And you have answered that at paragraph 65. And question 14 is:

15                    *For each of the Smiths' relationship managers, how long had they been a relationship manager, how long had they been employed by the bank, and how long had they been involved in agricultural lending?*

And your answer was that:

20                    *Between December 2014 and March 2017, Mr Bloomfield was the relationship manager.*

And that:

25                    *From May 2017, Mr McDowall is the relationship manager of Mrs Smith.*

Were you surprised to hear her say she's never heard of either of them?---Yes, I was.

30                    Is that acceptable?---It's not what – it's not what I would usually expect, although I am aware from the review of the file that there were notices posted at one of the properties where access was by invitation only.

Yes?---And trespass applied.

35                    Who is currently responsible for managing the Smiths' file within SBS?---It's Bruce Starky.

Okay. And he has been responsible for managing the file since the first farm debt mediation?---Yes, he has.

40                    All right. Has he put this file in the too hard basket?---No, I don't believe he has.

Do you think that he should be engaging with the local managers and the Smiths?---Yes, I do.

45                    And is that something you have spoken to him about since you reviewed this file?---I've discussed with him the – what has occurred over the last few years, in terms of that engagement with either the local banker or with the Smiths.

Why hasn't the NAB enforced any of its securities?---We – we don't want to take possession of – of the property. It's – it's not – we never want to, in any situation. Sometimes, it ultimately happens. In this case, as we tried to at farm debt mediation, we had the desire and hope that the Smiths would remain on the farm, and we – we  
5 hoped that would find a route through, and that's still exactly the same now, that we hope that we can reach a resolution whereby the Smiths stay on the farm, and find a way through to reduce the debt through – through cash flow.

10 Do you think that if the bank had taken possession of the property, after the Smiths had defaulted on their obligations under the deed of forbearance, that it would have been just as hard for the bank to find a buyer for Limbri?---Yes, I would expect so.

15 And the reason for that is, in heavily droughted country, nobody is buying?---That's my understanding, yes.

So the bank's in a difficult situation here because, even if it wanted to enforce, the reality is it's not going to be able to realise the asset?---Yes, I – I think that would be the case.

20 And isn't that just a further reason why the bank shouldn't have continued to apply default interest? The bank was charging default interest to the Smiths for failure to sell a property that the bank itself could not sell?---You know, we didn't want to take possession of the property to – to sell it, and – and in terms of a default interest, I – I think it was always an expectation that that would be resolved once the drought  
25 broke and once we got back to farm debt mediation.

Why didn't you want to enforce the mortgage?---Because we didn't want to take possession of the properties.

30 Why?---Because we wanted the – you know, we wanted to find a solution whereby the Smiths remained on the property.

All right. Can I show you another document. It's NAB.148.003.3728. This will be on the screen. It's not in any folder?---Okay.

35 It's only a short document. You may – I am only going to take you to one line. So you may avoid the need for a hardcopy – you're getting one anyway?---Thank you.

40 This is an email chain between Mr Avent and Mr Starky in November 2014. So to put this email in context, it's after default in the performance of the Smiths' obligations under the forbearance deed, and while default interest is running. And further below, there is a discussion between Mr Starky and some other people. Is the version that you've got redacted or is it just highlighted in blue?---Just highlighted in blue.

45 So you can see the names of the people in the email chain at the bottom there?---Yes, I can.

Right. Do you know who any of those people are?---The email chain between - - -

Bruce Starky and Geoff Howard?---Yes, I do.

5 And John – John Avent and Geoff Howard?---Yes.

I see. And then if you go over the page to 3729, this is Bruce Starky who currently manages and has at all times managed the Smiths' file from SBS, talking about available options in circumstances where they have defaulted?---Yes.

10

And can you see here it says, just after the first large paragraph at the top of the page, options – without the detail under each option:

*(1) appoint R and M.*

15

Do you understand that to be receiver and manager?---I do, yes.

Continuing:

20

*Appoint R & M now.*

It says under in brackets under it:

*Not acceptable due to the drought and political environment.*

25

And then number 2 is:

*Allow the customer to stay in control of the assets and appoint receiver and manager when it rains.*

30

?---Yes.

That's what the bank was contemplating in 2014?---I – I don't know that that's what they were contemplating. It was an option.

35

As an option?---Yes.

It says in brackets under that:

40

*If we are to do this we will need to be very open with the customers/advisers about this now, otherwise the ultimate political consequences will be severe. Probably as politically unacceptable as 1 above.*

Do you see that?---Yes, I do.

45

And then 2(b) is:

*Allow the customers to trade the business on an attempt refinance. Not acceptable to NAB as our debt is likely to escalate. No control over the livestock, no likely exit of the relationship.*

5 And then (c) is:

*Allow the customers a very short period after it rains (say three months) to either sell or refinance.*

10 And there's a comment:

15 *Given the political environment, I think we need to look at this, but only if we can get some controls in place. There is also the disadvantage of having gone through the mediation process, having drawn the line in the sand, and when they don't – ensuring the customers live up to the agreement – however, they have the excuse of drought.*

20 Do you think drought is a complete answer to their failure to perform their obligations under the deed, at least insofar as sale of Limbri is concerned?---Yes, I do.

25 Yes. And NAB – do you accept that there is nothing in this email that reveals any desire on the part of NAB to keep the Smiths in the property? This is a hard-nosed assessment of the options available to NAB, but there's no desire expressed as to the position of the Smiths?---Yes, I think that's correct.

And the two reasons given as to why the bank wouldn't appoint a receiver and manager are because of the drought is on and the political environment?---Yes.

30 And similarly there was the risk of political consequences if the bank waited for it to rain and then appointed?---Yes, that's what it says.

35 But there's nothing proactive in this email about how to get things on an even keel?---No, there isn't.

This is just considering enforcement?---No, it doesn't just consider enforcement.

And exit?---Yes.

40 Thank you. And if I could now take you to – could I tender that, Commissioner.

THE COMMISSIONER: Exhibit 4.115, emails between Avent, Starky and others, 10 November '14, NAB.148.003.3728.

45

**EXHIBIT #4.115 EMAILS BETWEEN AVENT, STARKY AND OTHERS  
DATED 10/11/2014 (NAB.148.003.3728)**

MR COSTELLO: Could I now show you NAB.148.020.2380. This is a much more recent email between somebody called Ashley Smith, who is no relation to the Smiths, and Mr Starky. And you can see there that in January – sorry, I should take you, in fairness, to the second page first, which is 2381. And there’s a hardcopy coming, Mr McNaughton?---Thank you.

On the second page there, this is Mr Smith emailing Mr Starky. He has “almost finished this one”. Do you think this is a review of the Smith file. Is that what he means?---I’m sorry, I – I don’t know.

Okay:

*My take is that the file is 99.*

That’s an ECRS rating, do you think?---Yes, it is.

Continuing:

*Because the deed after the farm debt mediation provided that we would not charge default rates, ie, we will not recover all interest in IAS.*

What’s IAS?---It’s impaired asset system, where we would – we would record provisions.

So this is an acknowledgement of the fact that the bank – so this is a recording of the fact that the bank – in the bank’s own systems it doesn’t expect to recover the interest?---Yes.

I see:

*Given that the customers have not met their obligations to sell, etcetera, in 2014, are we now entitled to charge and recover default rates, ie, should this be ECRS 98? Let me know, because it impacts a couple of questions in the assurance.*

So what’s this process, do you think, that Mr Smith is going through?---I think what he’s referring to is – is a self-assurance process that operates in SBS, whereby one impaired asset manager will review another manager’s file around – there’s a pro forma check.

Right. And so when Mr Smith says:

*Given that the customers have not met their obligations to sell, etcetera, in 2014, are we now entitled to charge and recover default rates?*

Is he labouring under a misapprehension as to what has happened with default interest?---Yes, he will be.

So he has reviewed the file but he hasn't realised default interest has been charged since 2012 on one facility and 2013 in the other?---Yes, I believe so.

5 I see. I see. And so – and he says, “If we were to – “ to paraphrase him, “If we were to charge default interest, it would become ECRS 98”?---That's correct

Is that right?---Yes, it is.

10 So does that mean that currently the Smith file is ECRS 98?---No. My understanding is it's ECRS 99.

So it's ECRS 99 which means, apart from other things, that the bank has accepted it won't recover the interest?---Yes, that's correct.

15 Okay. And then Mr Starky responds:

*While there is –*

20 On the next page –

THE COMMISSIONER: Go up a page rather than down a page; is that right?

MR COSTELLO: 2380.

25 THE COMMISSIONER: Yes.

MR COSTELLO: Yes. The first page of that document:

30 *Hi Ashley, while there is probably a legal right to now recover our full debt including default interest, there is virtually no chance that we will, as a result of the politics stemming from the five year drought and the potential impact on bank image.*

35 Is it a concern to protect NABs reputation that drives these decisions?---Not in itself, no.

It's one consideration?---Yes, it will be.

40 Is it the predominant consideration?---I don't believe so.

45 Do you accept that in this email – and by all means read the balance of it, if you would like to satisfy yourself – that there is nothing that Mr Starky points to, save for politics stemming from the five year drought and the potential impact on the bank image, that comes into his consideration as to the appropriate way to deal with this very difficult file?---Yes. That – the things you've highlighted are – are the only things that are in the statement that Mr Starky sends.

And that is consonant with some of the statements made by the same gentleman in 2014 in respect of the same file. Do you accept that?---Yes, I do.

5 So is the reason that NAB hasn't enforced this mortgage that it doesn't want to incur the political opprobrium that will come from enforcing it?---No, I don't believe so.

10 So Mr Starky here, who is the charged with managing the file, clearly had it front of mind in 2014 – he had it front of mind in January 2017, but you don't think why the decision has been taken not to enforce?---No I don't.

15 Well, why do you think the decision was taken not to enforce?---Because, as I said, I think – this is – this is a difficult file and I think that we still want to get to a point where we resolve the position with the Smiths through, most likely, a farm debt mediation. And we've taken no steps over that period to enforce our rights under our charges.

20 Well, quite. My point is directed entirely to the reasons why you haven't. Do you understand my question was why have you not enforced, and is the reason you have not enforced the reasons Mr Starky pointed to in 2014 and 2017?---No, I don't believe so.

And what is the basis of that belief?---That we wanted to get to resolution with them.

25 When you say we wanted to get to a resolution - - -?---Which – which results in what we tried to achieve under the farm debt mediation, and the deed of forbearance, where the Smiths would remain on the farm.

Is that what you want?---Absolutely.

30 And is it what anybody but you wants?---No, I don't believe so. I believe that's consistent with others across SBS.

And why do you have that belief?---Because no enforcement action has been taken.

35 Yes, but it's getting rather circular. The premise of the question is that no enforcement action has been taken?---Yes.

40 I've shown you two emails from the person who manages the file that has pointed to the difficulty in taking enforcement action, because the bank's reputation might be damaged if it were to do so, and the question that I've put to you, twice now is: is that the reason the bank hasn't enforced? And as I understand it, your answer is, "No, the bank hasn't enforced because it wants the Smiths to remain on the farm"?---Yes.

45 And my second question to you then is: what is the basis of your belief that that is the reason that the bank hasn't enforced in the face of the two emails I've showed you?---Over the – over the period that we are – that we're considering here, I am

aware that there have been other enforcement actions for other – other customers, and the fact that the – in this case, enforcement action hasn't been taken – hasn't been taken, sorry, isn't to my mind because of solely political motivation.

5 Do you think that in all of the circumstances that have struck the Smiths that, if a new deal was done, it would be fair to require them to divest both properties?---No, I don't.

10 Do you think that it would be fair to require them to destock both properties?---No, I don't.

15 Do you accept that the only way this can be fairly resolved is for the Smiths to remain in possession of a property and to have cattle from which they can earn an income?---Absolutely.

And is that something NAB will work towards?---Absolutely.

Thank you, Mr McNaughton. I have no further questions, Commissioner.

20 THE COMMISSIONER: Mr Thomas.

MR THOMAS: Just a few questions in re-examination, if I could.

25 THE COMMISSIONER: Yes.

**<RE-EXAMINATION BY MR THOMAS [3.29 pm]**

30 MR THOMAS: Mr McNaughton, do you recall being asked some questions - - -

THE COMMISSIONER: I'm terribly sorry to interrupt you, Mr Thomas. The last email chain, I think, was not tendered.

35 MR COSTELLO: In - - -

THE COMMISSIONER: Emails Ashley Smith to Starky, 11 January '17, NAB.148.020.2380, exhibit 4.116.

40 **EXHIBIT #4.116 EMAILS ASHLEY SMITH TO STARKY DATED 11/01/2017 (NAB.148.020.2380)**

45 MR COSTELLO: And while I'm on my feet, Commissioner, consistent with my conduct all day today, I didn't tender the APRA prudential standard that I took Mr McNaughton to. It is RCD.0022.0005.0001. And it is described as - - -

THE COMMISSIONER: Standard APS 220 with that doc ID is exhibit 4.117.

**EXHIBIT #4.117 STANDARD APS 220 (RCD.0022.0005.0001)**

5

MR COSTELLO: Thank you.

THE COMMISSIONER: Having twice interrupted you, Mr Thomas, now.

10

MR THOMAS: Thank you, Commissioner.

Mr McNaughton, do you recall being asked some questions about a document entitled the SBS Hardship Procedural?---Yes, I do.

15

That is, for the transcript, exhibit 4.114. Can I ask you to look at two different documents, if I could. The first of those documents is NAB.106.001.0674. Mr McNaughton, this should be a document with the heading HAR101.1?---Yes.

20

Do you have that in front of you?---I do.

Is this a document that applies to bankers within SBS?---Yes, it is.

25

Thank you. Could I then ask you to turn to the next document. The doc ID is NAB.106.001.0679. Do you have that document in front of you?---I do, yes.

Is this a document that also applies to bankers within SBS?---It does, yes.

30

Thank you. Do you recall being asked questions by my friend - - -

THE COMMISSIONER: Are we tendering those, Mr Thomas.

MR THOMAS: I tender both of those documents, Commissioner.

35

THE COMMISSIONER: The first one, financial hardship document, HAR101.1, NAB.106.001.0674, becomes exhibit 4.118.

40

**EXHIBIT #4.118 FINANCIAL HARDSHIP DOCUMENT HAR101.1  
(NAB.106.001.0674)**

THE COMMISSIONER: The second document, hardship notice HAR102, NAB.106.001.0679, 4.119.

45

**EXHIBIT #4.119 HARDSHIP NOTICE HAR102 (NAB.106.001.0679)**

MR THOMAS: Thank you, Commissioner.

Mr McNaughton, do you recall being asked questions by my friend about the possibility of the bank increasing the overdraft limit to “regularise the overdraft facility”?---Yes, I do.  
5

Do you recall whether or not the bank had previously increased the overdraft limit of the overdraft facility provided to the Smiths?---Yes, I recall that occurred in August of 2013.  
10

And do you agree with me that it actually occurred on four separate occasions, as set out in your statement at paragraph 68(a)?---Yes, I do.

Thank you. The third issue I wanted briefly to raise, Mr McNaughton is, in answer to a question from the Commissioner, you referred to notices that were on one of the properties. Can I just clarify and ask if the following document could be brought up, NAB.148.014.1706. Mr McNaughton, is this the notice to which you were referring in answer to the Commissioner?---Yes, it is.  
15

And are you aware of the person who took that notice or took that photograph?---Yes, I am.  
20

And is that an – was that an employee of NAB?---Yes, it was.

Do you know whether that employee, having taken that notice, proceeded to enter the property?---I’m not aware that they did.  
25

Thank you. Are you aware which of the two properties this photograph relates to?---No, I’m not.  
30

THE COMMISSIONER: Or when it relates to, what time?

MR THOMAS: It is otherwise dealt with in Mr McNaughton’s evidence.

THE COMMISSIONER: Yes.  
35

MR THOMAS: And so the record will show the date upon which the photograph was taken.

THE COMMISSIONER: I can find the date out of that.  
40

MR THOMAS: Yes, indeed.

THE COMMISSIONER: Yes. Thank you, Mr Thomas.  
45

MR THOMAS: And we will assist you in submissions in relation to that matter. Because it's already exhibited to Mr McNaughton's statement we don't need to tender the document.

5 THE COMMISSIONER: No need to tender it.

MR THOMAS: No further questions, Commissioner.

10 THE COMMISSIONER: Thank you, Mr Thomas. Mr McNaughton, thank you, you may step down. You are excused.

<THE WITNESS WITHDREW

[3.35 pm]

15

THE COMMISSIONER: Now that, I think is - - -

MR COSTELLO: There are no further witnesses - - -

20 THE COMMISSIONER: - - - all for today.

MR COSTELLO: - - - for today.

25 THE COMMISSIONER: No.

MR COSTELLO: The agricultural finance aspect will continue in Darwin on Monday with a case study concerning Rural Bank, before then moving to the second topic for this hearing block.

30 THE COMMISSIONER: So if we adjourn till 10 am on Monday next in Darwin.

MR COSTELLO: Thank you, Commissioner.

35 **MATTER ADJOURNED at 3.35 pm UNTIL MONDAY, 2 JULY 2018**

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