

National Australia Bank
500 Bourke Street
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11 May 2021

Mr George Christensen MP
Member for Dawson
Chair of Joint Standing Committee on Trade & Investment Growth
PO Box 6022
Parliament House
Canberra ACT 2600

Dear Mr Christensen

SUBMISSION TO THE INQUIRY INTO THE PRUDENTIAL REGULATION OF INVESTMENT IN AUSTRALIA'S EXPORT INDUSTRIES

National Australia Bank (NAB) welcomes the opportunity to make a submission to the Joint Standing Committee on Trade & Investment Growth. As a member of the Australian Banking Association (ABA), NAB has also contributed to its submission.

Australia's export industries are critical to our national economy and are playing a vital role in the nation's economic recovery from the COVID-19 pandemic. Our export industries and their associated businesses will also be central to Australia's ongoing growth and prosperity.

As Australia's largest business bank, and largest provider of finance to the agriculture sector, NAB works with small, medium and large businesses. We are focused on being a partner with our customers and working with them to develop financial structures and innovation that can help address the challenges and also capitalise on the opportunities emerging in their industries.

We fully support the Government's continued focus on generating growth opportunities for Australian exporters, including through expanding existing and pursuing new markets for Australia's key export products.

Australia's export industries

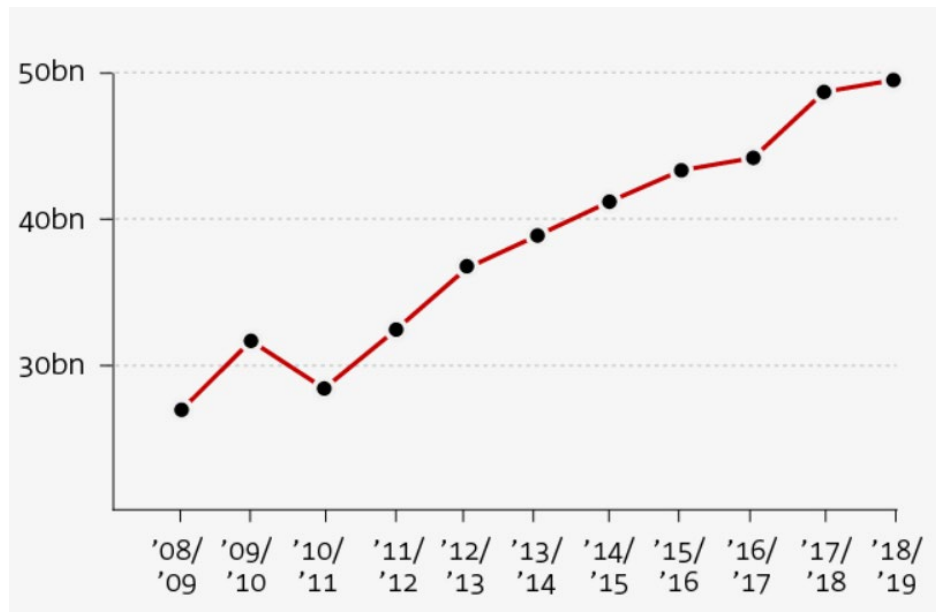
Australia has a proud history of exporting. Across a range of sectors, from natural resources to agricultural products and more recently services, including education, Australian companies have pursued international opportunities to help them invest and grow. We recognise the key contribution of our export industries to economic activity and employment, particularly in rural and regional Australia.

While Australia's exports have diversified and evolved, most of our export income currently comes from natural resources (in particular, iron ore, coal and liquefied natural gas (LNG)), which recently accounted for more than 60 per cent of Australian exports. This commodity export strength has been driven by the urbanisation of South Korea and Japan in the 1970s and 1980s, and then China especially since the early 2000s.

In recent years, Australia has also played a key role in meeting the global demand for high quality education and training. Education services were Australia's fourth largest export in 2018/19, following iron ore, coal and LNG.

Over the past decade, our agricultural exporters have also enjoyed tremendous growth (Figure 1). They have successfully positioned Australia as a strong, competitive and sought-after supplier of high-quality agriculture and seafood products.

Figure 1: Total agricultural commodity exports (value in \$billions)



(Source: NAB Economics; Australian Bureau of Agricultural and Resource Economics and Sciences)

COVID-19

While the COVID-19 pandemic caused major economic disruption and uncertainty worldwide, the resources and agricultural sectors have been a consistent strength for the Australian economy. Australia's comparative success in tackling the virus and our proximity to Asia have served us well for the most part. Even so, measures implemented in Australia and other countries to control the spread of COVID-19 (for instance, border closures, travel restrictions and physical distancing) have had negative impacts on trade and investment. In particular, border closures in early 2020 have had a material impact on our education exports, which relied on the arrival of international students into Australia. The shift to online learning and the industry-wide approach to manage costs has offset a considerable portion of the impact from students unable to reach Australia. However, the impact on smaller organisations affiliated with the higher education sector has been more dramatic. Purpose-built student accommodation and investment properties reliant on student rentals have experienced a more direct cashflow impact without the scale or strength of balance sheets of the universities. Notably, there has been no downgrade by an external rating agency of any of Australia's rated public universities and many have reported stronger than anticipated financial results for the period ending 31 December 2020. Nevertheless, we expect the impact of the pandemic on future international student revenues will result in a protracted recovery to pre-COVID levels for the university sector.

Global trading environment

China is Australia's largest trading partner, followed by Japan, South Korea and the United States. Although a number of Australian exports were subject to tariffs or other restrictions in 2020, China continues to be the largest importer of Australian products. In light of these changed conditions, exporters are exploring other markets – particularly in South-East Asia, where Australia has existing cultural ties, including from migration. We're seeing cotton growers pivot to Indonesia, Thailand, Vietnam and Bangladesh, and barley exporters are also tapping into markets in South-East Asia, as well as the Middle East and Mexico. NAB welcomes the Government's efforts to help open new markets for exporters.

As China increases its metallurgical coal imports from countries other than Australia, our exporters are diverting to India and South Korea. Growing steel production capacity in Vietnam, Malaysia and Indonesia is also offering some opportunity for Australian metallurgical coal. Even so, we are seeing significant price and export earnings impacts of current trade disruptions – for example, prices for Australian premium low-volatile metallurgical coal outside of China are about half that for similar coals delivered into China from other countries including Canada, the US and Russia.

With respect to thermal coal exports, other buyers around the world are switching to Australian thermal coal as China bids up the price for non-Australian thermal coal. Specifically, there is rising demand from South-East Asia. Longer term, however, the outlook for thermal coal is uncertain. A number of countries that are major importers of Australian thermal coal have made pledges for net zero carbon emissions by 2050 (for example Japan and South Korea). While it was previously expected that growing demand in South-East Asia would offset some decline in demand from China, Japan and South Korea, policy changes flagged in Vietnam, Indonesia, the Philippines and Bangladesh suggest demand for thermal coal is declining. This is reflected in scenario analysis included in the International Energy Agency's 2020 World Energy Outlook.

Climate action

A number of Australia's major trading partners are either planning or considering implementing carbon border adjustment mechanisms (CBAM) to support their emissions reduction targets. This would have flow on impacts for Australian exporters. For example, the European Commission plans to implement a CBAM for the European Union (EU), with a view to at least getting a pilot scheme up and running by the start of 2023. Although several models are still under consideration, the European Parliament has urged a direct link between the CBAM and the EU's emissions trading system (ETS), in which producers in carbon-heavy industries buy and trade permits to emit greenhouse gases. Such a model would see Australian companies exporting to the EU face a tax equivalent to the ETS carbon price paid by Europe-based competitors. It would be applied to the embedded carbon content in Australian goods exports unless Australia had a carbon price of its own or the exporter could demonstrate its low-carbon credentials. This could apply to direct exports from Australia to Europe, and indirect exports to intermediaries who then exported finished goods into Europe that were made with Australian resource and energy exports.

Japan is also studying carbon pricing, trading and border adjustment mechanisms. It is expected to announce policy positions late in 2021 that will align with and support targets to reduce carbon emissions by 46% by 2030, from 2013 levels. And more recently, the US confirmed it is also interested in evaluating the value of a CBAM to help curb emissions.

NAB's lending to businesses involved in export industries

NAB exists to serve customers well and help our communities prosper. NAB seeks to lend to support good investment, to help businesses grow and create jobs. The bank's lending book reflects the key industries in Australia's economy, including export industries.

As at 31 March 2021, NAB had exposure (EAD) of \$8.41bn to the natural resources industry. We provide debt or other banking services to a majority of natural resources companies in the ASX100 index as well as a significant number of exploration and junior mining customers. Our banking products and services including project finance, corporate finance, acquisition finance, equipment finance, trade finance, foreign currency, commodity hedging, bank guarantees, letters of credit, working capital, access to capital markets, deposits, transactional banking, rehabilitation performance guarantees¹ for mines across Australia and access to world-class commodity market research and insights.

As Australia's largest agribusiness bank, agriculture is a key priority for us. We've been working with Australian farmers for almost 160 years and now lend \$1 in every \$3 to Australian agriculture. We are supporting our customers to find new markets, hire more people and buy new equipment. In FY20, NAB's lending to agribusiness grew 8.4 per cent on the prior year, totalling \$31bn as at 31 March 2021. We lend to all agri sub-sectors across the value chain and specialise in advice for farmers and agribusinesses on sustainability practices, succession planning, ag tech innovation, cyber security, export and trade and funding growth including cash flow management and seasonality.

¹ Mining companies are required to rehabilitate mines at the end of operations, in addition to progressive rehabilitation during the term of the operations. State governments typically require financial assurance from mining companies to ensure this rehabilitation work is carried out and to mitigate the financial risk that the state will have to bear the cost of rehabilitation. This may take the form of contributions to a state-managed rehabilitation fund, provision of "sureties" by insurance companies or provision of rehabilitation guarantees (sometimes referred to as performance bonds) by financial institutions. NAB provides such rehabilitation guarantees on behalf of our customers, thus providing financial assurance to state governments for the expected cost of rehabilitation work. Where these are provided on behalf of thermal coal customers, they are included in NAB's thermal coal mining exposure figures.

NAB is the leading lender to the university sector in Australia and has continued its strong support throughout the COVID-19 pandemic. We have been central to assisting Australia's public universities in accessing global debt capital markets to help fund investment into the infrastructure required to drive world rankings and attract international students.

NAB has been a long-standing supporter of our manufacturing sector and recognises the critical role manufacturing plays within the Australian economy and across a range of sectors. We support a large domestic institutional manufacturing client base and are also the bank of choice for thousands of small businesses involved in manufacturing via NAB's extensive business bank franchise.

NAB believes that being a sustainable business is good business practice. It is our responsibility to make good long-term decisions and help support a strong economy into the future. We are mindful of the long-term challenges we face as a bank, which is why sustainability is a key anchor of NAB's refreshed business strategy.

Climate change is an issue that presents commercial risks and opportunities for NAB, for our customers and their communities. We are evolving our business to help manage the effects of climate change and support the transition to a low-carbon economy. This includes a commitment to achieve a net-zero emissions lending portfolio by 2050, consistent with transition pathways aligned to the Paris Agreement. Critically, we are doing this mindful of Australia's energy security, the challenges and opportunities of our major customers and the potential impacts on the communities in which they employ many Australians. We continue to support our existing customers across mining and energy sectors to facilitate an orderly transition to a low-carbon economy. These are commercial risk-based decisions, and as a relationship-led bank, we consider it is our responsibility to support customers through this transition.

We have seen a shift in climate awareness among our customers for some time. Given we want to work constructively with our customers, conversations about Environmental, Social or Governance (ESG) risk and sustainability have long been embedded in our processes. We also understand that customers' ESG performance can impact on their credit risk profile. Many of our customers are preparing for a net-zero emissions world and we have a natural interest in working with and supporting businesses as they undertake that preparation. We recognise that transitioning takes time and considered planning.

In November 2020, we announced we would work closely with 100 of our largest greenhouse gas emitting customers to support them in developing or improving their low carbon transition plans by 2023. Since then, we have developed a transition framework to help us understand the relative maturity of customers' transition plans. We are currently using that framework to support, encourage and work with our customers on their transition planning. While some customers are well-progressed in their low-carbon transition plans, others are just starting the process.

We recognise finance is a critical tool in responding to society's biggest challenges and have been driving and innovating sustainable finance options that support the low-carbon transition. For example, working with our customers on sustainability-linked loans (SLL), a financing arrangement that incentivises better environmental and social performance outcomes. We are pursuing these opportunities across our portfolio. NAB has just led the development of a SLL for Australia's largest east coast seaport, Port of Newcastle, which aligns financing with long-term environmentally and socially responsible outcomes. The SLL will help the Port adapt and improve the sustainability of its business, while also supporting new opportunities for jobs and economic growth in the Hunter region. On the back of this announcement, we have been approached by companies (both interested parties and existing NAB customers) across a range of industries that are keen to understand more about how we're working with Port of Newcastle and what it could mean for their business.

We also recognise that NAB has an important role in ensuring customers understand changing expectations of public and private capital investors. In addition to direct lending, many of our customers appoint NAB to act as lead manager on their capital markets transactions in Australia and offshore markets. We must understand investor appetite and pricing expectations to successfully execute transactions on behalf of issuers. There has been a significant shift towards responsible investment with signatories to the United Nations Environment Programme Finance Initiative's Principles for Responsible Investment (UNPRI), a network of investors working to promote sustainable investment through the incorporation of six ESG principles into investment practices and ownership decisions where consistent with their fiduciary duties. Signatories to the UNPRI have increased to over 3,500, with collective assets under management of more

than US\$100 trillion². The Central Banks and Supervisors Network for Greening the Financial System (NGFS) recognises that while still small compared to the overall market, bond and loan market instruments can play a transformative role by raising awareness and boosting accountability and transparency and that the demand for environmental and sustainable investments is large and on the increase. The NGFS also recognises that banks with deep experience in trading and derivatives products could support the development of carbon credit and trading tools to help clients and countries meet their emissions reduction commitments. NAB is focused on ensuring we have available the products and services across loans, bonds, derivatives and trading to support our clients meet their commitments and ambitions.

One further example of how we're helping our business customers adapt to the changing world is our ongoing work on managing the risk and seizing opportunities related to natural capital³. We recognise primary production (particularly agriculture) is, and will continue to be, important to Australia's economic future. We've been working with agribusiness customers and a range of research partners (CSIRO, the Australian Wine Research Institute, Queensland University of Technology and the Food Agility CRC and ClimateWorks) for some time to determine how we can best support our customers to deliver long-term growth that also generates positive environmental impacts. These research partnerships are helping us better understand the emerging opportunities for our agribusiness customers to complement farm income with environmental markets. For example, increasing soil carbon levels could improve a farm's production resilience while also creating the opportunity to generate income from carbon credits sold.

Risk management and regulatory settings

Risk is inherently part of NAB's business. Sustainability risk (including climate-related financial risk) is one of a number of categories of material risks that NAB has identified, which could negatively impact the risk and return profile, value or reputation of NAB or our customers and suppliers.

NAB's ability to manage risk effectively is critical to NAB being a safe and secure bank that can serve our customers well and help communities prosper. This is achieved through applying a Risk Management Framework, documented as part of NAB's Risk Management Strategy, which is provided at least annually to the Australian Prudential Regulation Authority (APRA) to meet our prudential requirements.

NAB's material risks categories are

- Strategic Risk
- Credit Risk
- Market Risk
- Balance Sheet and Liquidity Risk
- Operational Risk
- Compliance Risk
- Conduct Risk
- Sustainability Risk

NAB's Risk Management Framework is underpinned by consideration of the impacts of NAB's business decisions on customers, the community and NAB's people.

Responding effectively to those material risks with ESG implications is an important contribution to maintaining our financial performance, reputation, long-term strategy and vision.

We have policies and processes to identify, assess and manage ESG risks associated with our customers. Among other things, and as part of credit risk assessment and due diligence processes, these policies require our bankers to be able to:

- identify relevant legislation and regulatory requirements and assess a customer's compliance with these requirements
- assess how our customers manage ESG risks and performance

² <https://www.unpri.org/signatories/signatory-resources/signatory-directory>

³ Natural capital comprises Earth's natural assets (soil, air, water, flora and fauna), and the ecosystem services resulting from them, which make human life possible. Ecosystem goods and services from natural capital underpin productivity and the global economy. They provide services worth trillions of US dollars per year in equivalent terms and constitute food, fibre, water, health, energy, climate security and other essential services for everyone. Neither these services, nor the stock of natural capital that provides them, are adequately valued in terms comparable to manufactured and financial capital. Despite being fundamental to our wellbeing, their daily use remains almost undetected within our economic system.

- consider the impact of changes in legislation and regulations on a customer's business
- consider the impact of changes in societal expectations on a customer's business and the reputation risk that may be associated with a customer, and
- assess the risk of liability for ESG issues being transferred from a customer to NAB.

Bankers discuss ESG risks, opportunities and performance with their customers as part of their banking relationship. This enables them to better identify and assess any risks that may arise on a case-by-case basis.

ESG risks are identified, measured, monitored, reported and overseen in accordance with NAB's Risk Management Framework, consistent with the Financial Stability Board's *Task Force on Climate-related Financial Disclosures* (TCFD) recommendations.

Regulator expectations

All banks, including NAB, must disclose detailed information about risk exposures, capital adequacy and liquidity. Regulators in Australia and abroad have identified climate-related financial risk as a relevant factor that financial institutions must consider, along with the other categories of risks outlined above. For example, in April this year, APRA released for consultation its draft *Prudential Practice Guide CPG 229 Climate Change Financial Risks*. It is designed to provide regulated entities, like NAB, with greater clarity about regulator expectation in managing climate-related risks and opportunities as part of their existing risk management and governance frameworks. CPG229's overall objectives are to ensure that APRA-regulated entities understand risks (including physical and transition climate risks as well as liability risk) and opportunities that may arise from a changing climate; ensure investment, lending, and underwriting decisions are well-informed; and implement proportionate governance, risk management, scenario analysis and disclosure practices.

Additionally, NAB is participating in an APRA-led climate vulnerability assessment exercise, which is exploratory in nature and will involve using climate scenarios to understand risks and opportunities that emerge for financial institutions under a number of climate scenarios.

As a large corporate, NAB is also subject to an increasing range of other ESG-related legislation, including modern slavery legislation, which we must manage and in turn, expect our customers to manage appropriately.

Global initiatives

NAB is a signatory to, or participant in, a number of global initiatives relating to management and disclosure of climate and other sustainability-related risks. This includes the United Nations Environment Programme Finance Initiative's Principles for Responsible Banking. NAB also monitors the work of the NGFS, of which APRA is a member, including market insights on risk management and mobilisation of capital.

Trends and opportunities for Australia's export industries

Climate and energy

Energy demands are growing globally due to rapid urbanisation, population growth and an expanding middle class. Greenhouse gas emissions are also rising, leading to impacts on the climate as well as agriculture, disaster risk management and the economy more broadly. Meeting global energy demand in a clean and cost-effective manner will be a major challenge.

The LNG sector has been a critical industry within Australia, contributing to employment, investment and export revenue. LNG export volumes increased over the second half of 2020 and early 2021, driven by increased global energy demand, and we expect a gradual increase in average gas prices over the next two years as stronger economic growth supports demand, along with the transition towards gas-fired electricity generation, particularly in Asia⁴.

Australia is well placed to leverage our extensive clean energy resource bases, including some of the best combined solar and wind power resources globally. With our established expertise, Australia can become a

⁴ NAB, March 2021, NAB Minerals and Energy Outlook: <https://business.nab.com.au/wp-content/uploads/2021/03/Minerals-Energy-Outlook-March-2021.pdf>

world-class clean energy and technology provider. We also have the geographic advantage of being situated close to major trading economies in Asia. Australia has a long history of energy exports and has developed extensive infrastructure and trading relationships which can be leveraged to meet the region's demand for low carbon energy sources. For example, the opportunities to develop the world's first green hydrogen energy export industry. There are also opportunities to develop the world's first multi-gigawatt-scale renewable power project delivering power directly into South-East Asia via high-voltage direct current undersea cable.

NAB also sees a real opportunity to develop environmental solutions and processes for hard-to-abate industries, which would otherwise face significant challenges as the world decarbonises. In 2020, NAB alongside a number of customers joined the Australian Industry Energy Transition Initiative (AIETI). It aims to support Australian industry in hard-to-abate sectors to achieve net zero emissions by 2050, while managing the transition to a decarbonised global economy. The initiative is focusing on five supply chains that are critical to achieving Paris Agreement goals – iron and steel; LNG; chemicals, in particular plastics, fertilisers and explosives; aluminium; and other metals (lithium, cobalt etc).

Last year, Australia was the largest supplier of lithium to the global lithium ion battery industry. Its products are used in electric vehicles and batteries to firm renewable power. Global lithium demand is forecast to lift by eight to 12 times by 2030 as the energy transition accelerates. Australia can play a leading role in supplying high-quality and sustainable lithium chemical exports. Global copper and nickel demand is also forecast to grow very strongly as electrification of power and heat generation, and roll-out of nickel-rich batteries, accelerates. Australia's copper and nickel producers and exporters therefore have an incredible opportunity to grow and help meet global net zero carbon transition goals of major emitters in our region.

Agriculture

Export earnings from Australian agriculture are expected to surge in the next financial year with projections of a six per cent rise to around \$49 billion. Opportunities are most evident in East and South-East Asia, which are experiencing very high levels of economic growth that are likely to continue. Rising incomes generally lead to shifts in diet (reduced dependence on staple grains and increased consumption of meat, dairy and fruit), which is presenting a clear growth opportunity for Australian exporters.

Australia's clean and green brand and its reputation for safe, high-quality, trusted and verifiable export products is recognised globally. Our research and development in food and agriculture is world-leading, supported by a highly professional farming industry with strong technology adoption, presenting strong growth opportunities.

Education exports

While border closures due to COVID-19 have had a material impact on Australia's education exports, we consider there is good potential to rebound relatively quickly upon borders re-opening. Online education offerings have become more important during the pandemic. However, anecdotal experience suggests demand to return to in-person, cultural immersion remains relatively strong. This is due to Australia's relative attractiveness as a destination, the high quality of our universities and the potential for international students to gain employment and residency following completion of their studies. An increase in international students choosing to study in Australia, work post-study and ultimately seek permanent residency would help offset the head wind for population growth (where net overseas migration has driven growth in recent decades).

Manufacturing

Australia's manufacturing sector continues to grapple with innovation and scalability given global competitive dynamics. Focus on innovative work practices, and process efficiencies (particularly with respect to supply chains), coupled with increasing ESG risk and demand for sustainable business practices continue to dominate discussions as businesses look to technology-led advancements to deliver efficiencies and better management of business risks.

We recognise the need for greater investment across the manufacturing sector and welcome the Government's Modern Manufacturing Strategy. In that light, we are pleased to continue to engage with the Government on bringing to life its Modern Manufacturing Initiative with a focus on driving innovation and sustainability to provide a competitive edge to make our manufacturing sector globally competitive. NAB

can also help amplify manufacturing funding programs, given we already support large scale manufacturers and a significant number of smaller niche manufacturers.

Defence

With the stated \$200bn investment in the defence sector, there is potential for Australia to become a significant defence exporter. Investment in the domestic defence sector, combined with the increasing requirement for a material level of local content, will help emerging domestic defence suppliers enter the global supply chain. We would encourage a collaborative approach between the Government and the finance sector to help enable the flow of capital into the domestic supply chain. This would support the development of a world-class domestic defence supply base and help facilitate the participation of Australian-based suppliers in the global supply chain. Export Finance Australia (EFA) provides support for existing exporters under the national interest account (with some excellent examples that highlight the potential of this sector). A domestic equivalent of EFA's supports could also help encourage and nurture the development of small and medium enterprises (SMEs) in the defence sector.

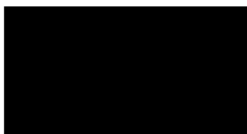
NAB and the South Australian Government commissioned a piece of research into the domestic defence and space supply chain which was finalised last year. On the back of that research, we believe there is an opportunity to work with the Government to explore ways to address the challenges faced by local defence SMEs when trying to access traditional banking products. These include length of time between bidding for a contract through to testing and ultimately to full-scale production, and limitations on taking collateral (bank security) over defence-related assets, including inventory and work-in-progress. There are a range of proven and emerging structures which can help improve access to capital which we would welcome the opportunity to discuss in more detail. We believe supporting a strong domestic defence supply chain will directly enhance suppliers' ability to ultimately participate in the global defence supply chain.

Conclusion

We hope this information assists the Committee with its inquiry. If you have any questions about this response, please contact Mary French, Associate Director, Government Affairs & Public Policy [REDACTED]

[REDACTED] We would be happy to provide further detail.

Yours sincerely



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