National Farmers Federation

National Farmers' Federation

Submission to the Standing Committee on Economics inquiry into the *Banking Amendment (Rural Finance Reform)* *Bill 2019*

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NFF Member Organisations

AGFORCE

ACGC Australian Chicken Growers' Council

Australian Dairy Farmers

Australian Forest Products Association afpa TREES | WOOD | PAPER

Australian Livestock Exporters' Council ALEC

ALPA

Australian Blueberry Growers' Association

Australian Organic

Australian Pork

AVA Australian Veterinary Association

BEECHWORTH HONEY

CANEGROWERS

Cattle Council of Australia

Cotton Australia

driedfruits australia dfa

FCA Farmers for Climate Action

GICA Goat Industry Council of Australia

GrainCorp

Grain Growers

National Farmers Federation Horticulture Council

NSWIC New South Wales Irrigators' Council

nsw FARMERS

Northern Territory Cattlemen's Association N.T.C.A

PAD

PET Primary Employers Tasmania

ppsa Primary Producers SA

Ricegrowers' Association of Australia Inc

Sheep Producers Australia

SoilsForLife

Summerfruit Australia

Victorian Farmers Federation

WAFARMERS

WoolProducers Australia

National Farmers Federation

The National Farmers' Federation (NFF) is the voice of Australian farmers.

The NFF was established in 1979 as the national peak body representing farmers and more broadly, agriculture across Australia. The NFF's membership comprises all of Australia's major agricultural commodities across the breadth and the length of the supply chain.

Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations form the NFF.

The NFF represents Australian agriculture on national and foreign policy issues including workplace relations, trade and natural resource management. Our members complement this work through the delivery of direct 'grass roots' member services as well as state-based policy and commodity-specific interests.

Statistics on Australian Agriculture

Australian agriculture makes an important contribution to Australia's social, economic and environmental fabric.

Social >

There are approximately 88,000 farm businesses in Australia, 99 per cent of which are wholly Australian owned and operated.

Economic >

In 2017-18, the agricultural sector, at farm-gate, contributed 2.4 per cent to Australia's total Gross Domestic Product (GDP). The gross value of Australian farm production in 2017-18 is estimated to have reached $60.1 billion.

Workplace >

The agriculture, forestry and fishing sector employs approximately 323,000 people, including full time (236,700) and part time employees (84,300).

Seasonal conditions affect the sector's capacity to employ. Permanent employment is the main form of employment in the sector, but more than 26 per cent of the employed workforce is casual.

Environmental >

Australian farmers are environmental stewards, owning, managing and caring for 51 per cent of Australia's land mass. Farmers are at the frontline of delivering environmental outcomes on behalf of the Australian community, with 7.4 million hectares of agricultural land set aside by Australian farmers purely for conservation/protection purposes.

In 1989, the National Farmers' Federation together with the Australian Conservation Foundation was pivotal in ensuring that the emerging Landcare movement became a national programme with bipartisan support.

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Executive Summary

Loans from Authorised Deposit-taking Institutions (ADIs) are a key source of finance for small farm businesses. It is important that the conditions attached to these loans are fair for both the lender and borrower. They should not leave small farm businesses vulnerable to sudden or unwarranted lender behaviour which materially harms the financial position of those businesses. We believe that the conditions which would be mandated by the *Rural Finance Reform Bill 2019* if it was legislated would result in fairer lending practices. For this reason, we support the Bill.

Introduction

The National Farmers' Federation (NFF) thanks the Committee for the opportunity to provide comment on the *Banking Amendment (Rural Finance Reform Bill) 2019* (the Bill). To preface our comments on the Bill, it is important to explain the importance of farm businesses being able to source debt finance with appropriate safeguards.

The Importance of Debt Finance

The Australian Farm Institute has identified a decline in the rate of productivity growth in the agricultural industry which must be reversed if Australia is to remain competitive with other major agricultural exporting nations. The prime reason for this decline is that the major force driving productivity growth over the past several decades – the substitution of labour for capital – has nearly run its course with existing technologies. Reversing this trend in productivity growth depends, therefore, on the ability of farmers to access the finance necessary to improve farm infrastructure, scale up production by purchasing land and water, and acquire new technologies[1].

Historically, debt finance sourced from financial institutions has been the primary means by which farmers have secured the capital required to operate and expand their businesses. This has two implications. The first is that debt finance is already of high importance to the industry. The second is that – assuming the historical primacy of debt finance continues into the future – the importance of debt finance is likely to increase over the coming decades as the industry seeks to fill the $600 billion shortfall in capital needed to achieve competitive productivity[2,3].

There are reasons why the conditions attached to debt finance in the agricultural industry should be different from those attached to debt finance in other industries. Foremost among these is the volatility of farm income and costs. Fluctuations in seasonal conditions and international commodity prices, international market disruption, and fluctuating input prices (e.g. water) are major contributors to this volatility. Even under the best conditions, farm income is seasonal. Several schemes and policies exist to help farmers manage this volatility. Farm Management Deposits and income tax averaging are two prominent examples. Debt finance sourced from Authorised Deposit-taking Institutions (ADIs), however, remains a primary tool used by farmers to manage income and costs volatility. Debt finance provides the cash flow needed to run farm businesses between extended periods of no or low income and ongoing costs[4]. An indication of the contribution of debt finance to the running of farm

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[1] Australian Farm Institute 2016, *A Review of Farm Funding Models and Business Structures in Australia*
[2] Australian Farm Institute 2016, *A Review of Farm Funding Models and Business Structures in Australia*
[3] ANZ Insight, *Greener Pastures: The Global Soft Commodity Opportunity for Australian and New Zealand*
[4] Debt finance is also important in growing farm businesses.

businesses is the increase in the average real debt carried per broadacre farm between 1990 and 2015 from $200 000 per farm to over $500 000 per farm[5].

The Importance of Fair Loan Conditions

This link between debt finance and the viability of farm businesses confers great importance on the fairness of the conditions attached to loans.

A 2016 report from the Australian Small Business and Family Enterprise Ombudsman found an '*almost complete asymmetry of power in the relationship between banks and small business borrowers. This manifests itself in:*

- *Extremely complex, one-sided contracts that yield maximum power to banks to make unilateral changes whenever they like and without the agreement of borrowers;*
- *Inadequate timeframes around key loan milestones that leave borrowers vulnerable;*
- *Misleading and conflicting signals between bank sales staff and credit risk staff which leaves borrowers vulnerable;*
- *Lack of transparency and potential conflict of interest in dealings with third parties involved in impaired loan processes, such as valuers, investigative accountants and receivers; and*
- *Significant gaps in access to justice with nowhere to go except the court system, with borrowers having limited resources and banks having overwhelming resources[6].'*

These findings, which are not exclusive to farm businesses, highlight the need for stricter conditions on loans to small farm businesses. We believe that the conditions which would be mandated by the Bill, if legislated, would result in fairer lending practices. For this reason, we support the Bill.

We also note Recommendation 1.11 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 'a national scheme of farm debt mediation should be enacted'. We support this recommendation and believe that such a scheme would complement the Bill. The proposal for a national farm debt mediation scheme shares the same purpose and seeks to address similar issues as those the Bill seeks to address: to decrease the power asymmetry in the relationship between banks and small farm businesses and protect these businesses in times of hardship.

We note that the extension of unfair contract terms provisions from consumers to small business was done in recognition of the fact that the power imbalances between lenders and small businesses often does not differ in any substantive way from the power imbalance between consumers and businesses. In the words of the Australian Securities and Investment Commission (ASIC), 'Small businesses, like consumers, are often offered contracts for financial products and services on

[5] Australian Farm Institute 2016, *A Review of Farm Funding Models and Business Structures in Australia*
[6] Australian Small Business and Family Enterprise Ombudsman 2016, *Inquiry into Small Business Loans*

a ‘take it or leave it’ basis, commonly entering into contracts where they have limited or no opportunity to negotiate the terms[7].’

We provide below our position on each of the Bill’s key reforms.

Requires ADIs to provide a simple one-page summary (‘Key Facts Sheet’) of the clauses that may trigger a non-monetary default by the borrower.

The NFF supports this reform. It will improve the transparency of loan conditions and protect small farm businesses from unwittingly triggering a non-monetary default. Since this reform relates only to the visibility of a loan’s conditions and not the conditions themselves, it should not have any substantive impact beyond improved transparency.

Prohibits ADIs from being able to unilaterally undertake or arrange for a valuation of any security given in respect of the loan.

We note that the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry recommended that valuations be independent of loan origination, loan processing and loan decision processes[8]. In its *Credit Risk Management Draft Prudential Practice Guide,* the Australian Prudential Regulation Authority asserts that ‘Conflict of interest exists if personnel who undertake the valuation are the same as those who are engaged in the origination, assessment and approval process[9]’.

We have no view on whether the provision in this Bill that would limit the ability of ADIs to unilaterally undertake or arrange for a valuation of any given security are necessary or preferable.

Prohibits ADIs from including catch-all material adverse change clauses in their loan documents, except where it relates to fraud or criminal activity.

We agree that catch-all material adverse change clauses should be prohibited. ASIC has judged them to be unfair on the grounds that they ‘give the banks a very broad discretion to call a default against the borrower without giving the borrower any clarity about what types of change could result in a default[10]’. We consider loan terms which specify which circumstances trigger a default is fairer than a loan which does not give this certainty.

We would caution against the prohibition of all material adverse change clauses (we acknowledge this Bill does not call for such a broad prohibition). These clauses allow banks to hedge against the risk of default. Preventing banks from using these clauses may have the counterproductive effect of lowering their willingness to lend to small farm businesses.

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[7] Australian Securities and Investments Commission, *Report 565: Unfair Contract Terms and Small Business Loans*
[8] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report: Volume 1*
[9] Australian Prudential Regulation Authority 2019, *Prudential Practice Guide: APG 220 Credit Risk Management*
[10] Australian Securities and Investments Commission, *Report 565: Unfair Contract Terms and Small Business Loans*

Requires ADIs that conduct valuations of any security to a loan, to provide a copy of valuation instructions and final valuation reports to the borrower. ADIs must not require the borrower to meet any part of the cost of the valuation.

The NFF supports this reform. It would prevent a small farm business being forced to pay for the valuation of a security undertaken by a bank for that bank's own purposes. We support a copy of the valuation instructions and final valuation report being provided to the borrower. This should help ensure that the valuation process is independent of loan processing.

This reform could also be expanded to allow any lender to rely on a valuation even if commissioned by a different lender. This could increase competition amongst lenders by removing one of the key costs and delays faced when changing or comparing banks.

Requires ADIs that conduct audits (i.e. investigative accounting) of the business, to provide a copy of the report to the borrower. ADIs must not require the borrower to meet any part of the cost of the audit.

The NFF supports this reform. Even when the power to appoint an auditor is specified in the terms and conditions of a loan, the ADI has the discretion to decide if/when to appoint an auditor. This has the potential to impose significant costs on farm businesses without their consent when they are managing financial hardship[11].

We also support ADIs being required to provide borrowers with a copy of the report, in the interests of transparency.

Requires ADIs to provide a 30-business day notice period where it intends to exercise a power under a general restriction covenant, except where it relates to fraud or criminal activity.

The NFF supports mandating that ADIs must provide small farm businesses with a 30-business day period to remediate whatever situation resulted in the covenant being breached. If the situation is remedied with the 30-business day period, the ADI should be prevented from exercising a power under this covenant. Since the purpose of a restrictive covenant is to prevent the debtor from undertaking specific activities (or exceeding certain financial ratios) on the basis that these activities increase the risk of default, the ceasing of these activities will remove the increased risk and thus remove any need to exercise the power in question.

Requires ADIs to notify and request to meet with the borrower at least six months prior to the expiry of a term loan.

We support this reform. It is a change to process which should not have any financial ramifications for either the ADI or the farm business. It will increase the transparency and openness of the lending process (specifically, it will increase the transparency and openness around the possibility of renewing or extending a loan) and require ADIs to engage with farm businesses in good faith.

[11] Australian Small Business and Family Enterprise Ombudsman 2016, *Inquiry into Small Business Loans*

Prohibits the ADI from unilaterally varying a term or condition of the loan unless:

- ***the ADI has given the borrower at least 6 months written notice; or***
- ***the borrower has failed to comply with a term or condition of the loan (and the non-compliance is not of a minor or technical nature); or***
- ***the change reduces the obligation of the borrower or extends time for payment or is a change in a rate payable under the loan that is determined by referring to a reference rate.***

The NFF supports this reform. Again, we defer to the judgement of the Australian Securities and Investment Commission: 'Clauses that give lenders the unilateral ability to vary contracts without agreement from the small business borrower have a high risk of being unfair as they cause a significant imbalance in the rights of the lender and small business borrower (in favour of the lender) and are unlikely to be reasonably necessary to protect the legitimate interests of the lender if they can be used in a broad range of circumstances to make a broad range of variations to the contract[12]'.

Additional Comments

NFF also considers there is scope to expand these reforms to encourage greater competition amongst lenders. This could be achieved by changes to banking rules that reduce the financial and time cost of changing lenders.

This could be assisted by expanding the provisions to allow any lender to rely on a valuation even if commissioned by a different lender, and making it possible to avoid the discharge of an existing mortgage and the requirement of registering a new one when changing lenders.

If the terms of the mortgages were standardised, the only necessary requirement to change lenders would then be a "Transfer of Mortgage" single page document. No real loss of protection to the banks would result because:

- the effective operational terms of the loan (that is, the interest rate, term, fees, etc) are always in the "Loan Agreement" which is internally generated, not registered on the title and has no statutory requirements for execution etc
- the banks all have very similar forms of mortgage document which specify, inter alia, that the terms of the "Loan Agreement" will be deemed part of the mortgage
- the banks usually have a separate form of mortgage for Residential, Rural and Commercial so all that would need to be legislated would be for three standard forms of mortgage.

Additionally, the practice of completing numerous credit checks whilst considering different lenders is currently discouraged as it can appear the

[12] Australian Securities and Investments Commission, *Report 565: Unfair Contract Terms and Small Business Loans*

consumer is being denied credit by a number of providers. Further transparency on this issue could assist prospective borrowers.

Measures such as these, designed to increase effective competition amongst lenders, would then assist farmers in gaining access to improved lending rates and better access to affordable finance.

Yours sincerely

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