

**2012 Senate Inquiry into the
post-GFC banking sector**

National Australia Bank

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Mr Tim Bryant
Senate Standing Committees on Economics
Suite SG.64 / PO Box 6100
Parliament House
Canberra ACT 2600, Australia
By email: economics.sen@aph.gov.au

Dear Mr Bryant

The National Australia Bank (NAB) welcomes the opportunity to provide comment to the Senate Standing Committee on Economics Inquiry into the post-GFC banking sector.

NAB is a member of the Australian Bankers Association (ABA) and we have contributed to, and support their submission to this Committee on behalf of the banking industry.

This submission seeks to provide comment on those issues before the Committee where NAB has particular expertise or industry experience to further assist the inquiry and wider Parliament. Specifically, details of our recent lending and funding activity are included, as well as observations on current domestic and international regulation.

Further, please find enclosed: An overview of costs of funding and deposits & a summary of NAB's commitment to business and consumers.

Finally, NAB remains available to meet with Committee members to expand upon the NAB submission; if you require further information on this matter, please contact Dallas McInerney, Group Manager, Government Affairs & Public Policy, t: .

Yours sincerely,

Mark Joiner
Executive Director Finance
NAB

Bruce Munro
Chief Risk Officer
NAB

Summary

The National Australia Bank (NAB) supports a strong and competitive banking system.

Australia's economy continues to benefit from the banking industry's efficiency, innovation and reinvestment which have been facilitated by the progressive deregulation of the sector since the late 1970s.

Today, Australian banks offer customers a wide range of banking products and solutions; these offerings are complemented by the mutual sector in the form of credit unions, building societies and other non bank financial institutions.

Maintaining a strong and competitive banking system into the future is crucial to Australia's capacity to take advantage of economic growth opportunities. A strong banking system is necessary to attract global funding, preserve the safety of deposits, moderate and manage through disruptions and economic cycles, and avoid the economic crises that follow perceptions of a weakening of the banking system.

The Australian banking industry operates within a complex and expanding framework of federal, state, local and international regulation. While most domestic regulation of banking is managed under the auspices of Commonwealth regulation, the industry is also subject to State and Territory regulation in areas of trading, taxes, duties and OH&S.

Banks are well supervised by the Australian Prudential Regulatory Authority (APRA) and the Australian Securities and Investments Commission (ASIC), and our relative strength during the global financial crisis was in significant part due to our demonstrated prudent and conservative management. This framework of strong internal risk management, regulation and market supervision enabled us to largely avoid the major dislocations and failures which were a feature of northern hemisphere markets during the GFC.

Over the last 3-4 years, there has been seen a dramatic increase in regulation at all levels and while NAB considers many of these reforms necessary, change and the impacts of change, have not always been introduced within the wider context of reform, nor with an understanding of the compliance effort and timeframes required to make those changes.

In response to the global financial crisis, banks are subject to an array of complex, expansive and interconnected set of international regulations. NAB, having a presence in Asia, NZ, the UK and the US, is not just impacted by the host country regulation, but is subject to a growing body of cross-border regulation

introduced by international bodies such as the Basel Committee on Banking Supervision (BCBS) and regulation introduced by individual countries with intended extra-territorial reach.

Within this context external regulatory change, NAB has self initiated a series of changes based on real, measurable and tangible benefits for our customers. This *Fair Value* agenda is about providing a fairer value exchange between us, our customers, our people, our shareholders and the broader community. NAB has a view that this approach will change the economic model for retail banking in Australia.

In the past few years, NAB has undertaken a number of initiatives. These include removing a range of bank fees or giving the disadvantaged better access to financial services.

NAB has also continued to grow and expand our support for Australian business across a full range of banking activities. Crucially, our support for this sector increased during the GFC, at a time when much of the financial industry retreated and withdrew its support.

From November 2008 to February 2012 NAB increased its business lending by almost \$20bn whilst other banks combined reduced their lending by \$41bn (APRA data February 2012).

As a large domestic commercial bank, NAB plays a critically important role in our national economy. We consider our ongoing support for SMEs and business generally during the GFC as paramount importance. NAB leads the way in this area with almost a quarter of all business lending (APRA data, March 2012 – 24.6%). In lending to small and medium businesses our market share is about 30%.

In a healthy economy, financing the productive capacity of the SME sector is critical to Australia's long-term economic prosperity. Access to credit on fair terms and conditions to SMEs helps those businesses grow and in turn create employment which creates more growth and wealth. It is a virtuous cycle and reflects the key role banks play in society.

As Australia's leading business bank, NAB Business Banking has a team of over 5,000 business and specialist bankers nationally. The business includes operations, marketing, and finance professionals who service the full spectrum of the business sector, from small businesses through to Australia's largest ASX-listed corporations. Furthermore, NAB's unique and enduring relationship with Australian business enables it to act as a leading advocate for the business community, in particularly the SME sector.

In recent years, NAB's Business Bank has been actively engaged with the issues concerning credit flows and access for small businesses – our on-going commitment to provide direct finance to Australian small businesses is unmatched by any other financial institution. Over the past four years, NAB has invested heavily in customer facing relationship roles to assist and support small business owners, and prospective small business owners.

This investment to date has realised an additional 500 staff directly working with customers, giving NAB the capacity to provide an individual relationship manager to approximately 150,000 more small businesses, above and beyond our current customer base.

As referenced above, NAB has been growing its network of business bankers significantly; importantly, each banker has individual local authority to assess and approve business loans applications.

We pride ourselves on identifying the corrosive potential of the GFC on the Australian business community early and facilitating strong and consistent financial support for our job-creating, wealth-generating business and small business sector. The combination of our strong branch and banker network, our relationship banking model, our Fair Value agenda combined with a strong and uncompromising commitment to financially support Australian business in good times and bad played an important role in mitigating the impact of the GFC on the local business community.

A full summary of our Fair Value initiatives can be found in [Appendix 1](#).

Regulatory change

NAB has been an active and constructive participant in the area of banking reform. In many aspects, such as the move to fees for service in the financial planning industry and fairer banking and consumer credit reforms, NAB has lead the industry and have been committed to working with the Government to achieve an outcome of mutual benefit to consumers and financial services providers. The ABA submission details the extensive and significant list of domestic regulation affecting the banking sector over the last few years.

As a key participant in the Australian banking industry, NAB is also subject to global regulatory change and the last 5 years have seen a substantive upswing in international regulatory reform as result of the instability in financial markets and political pressure to respond to structural weaknesses in regulation.

Notwithstanding our support for some of these domestic and international reforms, we have been concerned that the pace and scope of changes across the industry - in light of multi-layered and interconnected reforms at national, state and international levels, raises the risk that not 'getting the detail right' on these reforms risks unintended consequences that could ultimately flow through to consumers.

We believe that it is important to ensure a balance between imposing additional regulation on banks and providing protections for consumers. The industry is already heavily regulated and there is significant additional regulation, both international and domestic, currently being progressed. There are numerous legal and regulatory obligations to ensure banks are managed prudently and to ensure banks provide their products and services in a transparent, accessible and responsible manner.

In NAB's view, many regulatory reforms fail to take sufficient account of industry's need to implement these interconnected reforms in planned, orderly and workable timeframes. For example, banks set periodical "windows" where we are able to open up our IT systems for making normal business changes and changes necessitated by regulation. This is to avoid ad hoc, ill-timed interventions into these systems. In order to embed changes into compliance frameworks and change the way we interact with each other and our customers, banks need to plan well in advance. These are changes that have to be made in a planned, resourced, and orderly way and cannot just be done at the "flick of a switch".

The heavy penalties for compliance contraventions, including the reputational damage makes getting things right the first time increasingly important.

As a member of the ABA, NAB is broadly supportive of their submission to this Inquiry and in particular, supports their principles for sound regulation on found on the first page of their submission – these would also be in line with the Australian Office of Best Practice Regulation standards – which we would ask the Australian Government to return to following.

Internationally, we have seen a growing trend in governments seeking to use regulation as a tool to protect national interests and companies, generate revenue, and preserve their own power. This trend of movement away from global standards is testing the ability of our compliance teams to track and monitor changes.

NAB has seen a significant increase in our compliance budget through a dramatic increase in regulatory change.

As an Australian bank, we must deal with regulation emanating from other countries (rather than international rule-setting bodies such as the Basel Committee on Banking Supervision – covered in more detail below), often without apparent regard by the regulators concerned for the scope of the extra-territorial impact of the new rules. Key examples, all from the United States, include the Patriot Act, Sarbanes-Oxley, the Foreign Account Tax Compliance Act, and Dodd-Frank. Dodd-Frank is described briefly below. The ABA submission covers the scope of these regulatory changes in more detail and we would refer the Committee to that submission.

NAB is impacted by the US Dodd-Frank legislation due to our ownership of Great Western Bank and bank holding company status in the US. There are a number of areas of Dodd-Frank that will impact our business over the next 2-3 years, covering our Wholesale Banking operations, our Great Western Bank holdings and our MLC/Wealth arm. Although the Volcker Rule has a long implementation schedule, regulators are currently considering the final regulations, and struggling to agree them prior to the July 2012 effective date.

NAB has concerns around extra-territorial impacts, proprietary trading / market making definitions, the effect on Australian government bond markets, and the impact on investment funds. Of particular concern to Australia is the impact on investment funds given the unique nature of the Australian superannuation industry. Whilst some of the above issues are in common with other geographies outside the US, the investment funds issue merits ongoing attention.

Industry associations in the US have advised that direct government to government/regulator comments are affective at influencing the way the regulators in the US approach final regulation. **Any additional support the Australian Government could provide to the industry, either directly or via regulators would be appreciated.**

Assisting our Customers in Financial Difficulty

The GFC had an adverse impact upon a significant number of both our business and retail customers. If a customer is having difficulty meeting their obligations we encourage them to contact us as soon as possible so we can discuss those difficulties.

Our Retail Customers

NAB invests an enormous amount of time and effort in gaining new customers and it is in our and our customers' interest to keep those relationships

To that end NAB has a relationship based collections approach including a team dedicated to assisting those customers who are facing genuine hardship - with a view to helping those customers get back on their feet.

People who are facing genuine hardship include those who are going through family breakdown, have lost their job or are even recovering from illness.

Remedies to hardship depend on the customer's situation – however – might include helping them to consolidate debt or making contractual changes to allow a bit of breathing space.

NAB takes a structured approach to mortgage collections with foreclosure/ repossession the last option. Our approach is in line with our key competitors.

The terms and conditions on NAB's term home loans are such that if the loan goes into arrears, we do not charge a higher interest rate on the loan and continue to charge the same interest rate that applied prior to the loan going into arrears.

NAB Care

NAB established a specialised team that provides specialised guidance, assistance and advice to help customers experiencing financial hardship – NAB Care.

The aim of NAB Care is help customers before they reach the collections process.

Financial hardship is when a customer is temporarily unable to make the minimum repayments to their NAB credit facility due to a change in circumstances. Examples of a change in circumstance can include but are not limited to:

- Loss of Employment
- Reduction in the number of hours (e.g. for casual or part time workers)
- Unexpected Bills/Expenses
- Death
- Medical Condition
- Incarceration
- Accidents (at or outside of work)
- Natural Disasters
- Social Problems
- Pregnancy
- Divorce/Separation
- Downturn in Business (for self-employed)
- Any other circumstances affecting the customer's ability to meet their contractual payments

NAB Care helps borrowers in need by offering real solutions to get customers back on their feet, offering temporary relief from contractual payments and provide case by case guidance and support.

NAB is obliged under the National Consumer Credit Protection (NCCP) Act to offer hardship variation to credit contracts for customers experiencing financial difficulty. Under the code of Banking Practice we are also obliged to assist customers to overcome financial difficulty with all credit facilities regardless of whether or not they are regulated by the NCC.

As part of this process our customers must be prepared to share all information about their finances as without an accurate financial position it is difficult for NAB Care to help. This information includes the customers' income, household expenses, all debts they owe and all assets they own.

In 2011 NAB Care gave assistance to 39,454 customer's accounts. In 2011 NAB Care also provided assistance to over 6,000 customers affected by natural disasters across Australia, and have continued to make contact with these customers to ensure that we continue to support those that need it most.

Our Business Customers

The majority of NAB's business customers in financial difficulties operate within the regulatory thresholds established by the Code of Banking Practice and the *National Consumer Credit Protection Act*. We provide our business customers with the same types of assistance as our retail customers.

NAB's core customer proposition is the same regardless of where a customer is located. It involves:

- an individual approach which endeavours to identify and understand the drivers of the financial difficulty;
- an evaluation of the potential of the customer to work through their financial difficulty within a reasonable timeframe and in a way that does not worsen their overall financial position;
- the maintenance of an open, ongoing communication with the customer throughout the process, ensuring what the potential next steps may be are clearly articulated. Options and alternatives the customer also has are clearly articulated.

Our relationship managers play a key role in assisting business customers to early identify potential problems before they become critical. With businesses, early help is often critical as delays can significantly address our ability to work with a customer in achieving a successful outcome. Our relationship managers remain a primary contact point for the customer and provide continuity for both the bank and the customer whilst their action plans are being negotiated.

Every customer is different and the financial difficulties that some of them face are similarly varied with their own individual characteristics. What this means is that there is no specific standard approach when we deal with a business customer in difficulty. We work with the customer to individually tailor a solution that matches their situation. The value for NAB is in developing a solution that meets the individual needs of each customer.

An example of NAB's strong and proactive approach to assisting business customers in distress is in the area of Agribusiness. NAB is Australia's largest banker to the agricultural sector. We endeavour to work with farmers who are facing challenging financial circumstances by taking a collaborative approach and working towards finding a mutually acceptable solution.

NAB does this by:

1. At all times maintaining open communication channels with the farmer. The farmer's banking relationship is maintained by the existing Agribusiness banker (with geographical proximity to the farmer, and knowledge of local area conditions), assisted with input from a specialised Agribusiness manager trained in dealing with challenging financial circumstances.
2. We encourage farmers to obtain assistance from rural counsellors, and where appropriate, independent legal and financial advisers.
3. In every instance, we work with the farmer to reach a customised outcome, tailored on a case by case basis to the farmer's specific circumstances. These solutions include allowing time to reduce debt levels through assets sales, restructuring facilities, or flexible payment options.
4. In NSW, Vic, Tas, and Qld, we utilise the *Farm Debt Mediation* legal process. This is a mandatory process by which NAB and the farmer work with an independent mediator to reach an agreement

that will accommodate each of the parties' circumstances and needs. Farm Debt Mediation in NSW for example is an example of positive legislative regulation that delivers value for customers and debtors.

NAB's experience is that Farm Debt Mediation is often the catalyst to help a customer understand the true extent of their financial difficulties.

Where a solution cannot be reached, and as a last resort, NAB follows the required specific state-based legal processes. As a guide, after Farm Debt Mediation has occurred, and if a mutually acceptable outcome cannot be achieved, generally the legal processes will take 6 months or more.

Farm Debt mediation is currently done on a State by State piecemeal basis. **NAB and the ABA supports the introduction of a single, national, consistent Farm Debt Mediation process – we submit this is policy initiative for the Committee to possibly consider further.**

Prudential Regulation

On 6 September 2011, APRA released a discussion paper outlining its proposed approach to implementing Basel III (“B3”) capital reforms in Australia (“APRA’s Discussion Paper”) and invited submissions from interested stakeholders. NAB made a submission to APRA, and also contributed to the ABA submission. On 30 March 2012, APRA released a response to issues raised in submissions along with five draft prudential standards for further public consultation (“APRA’s March 2012 release”).

The Committee has expressed an interest in understanding the costs of impending regulatory change due to the Basel reforms, and the impact we expect it to have on customer borrowing cost. To assist the Committee, we provide the following information.

For NAB, the main cost associated with regulatory change in the order of magnitude (and excluding the capital requirements) are:

1. Switching out of wholesale deposits, to more stable retail deposits.
2. The cost of building up a High Quality Liquid Asset portfolio. In Australia APRA have limited the securities we can hold in this portfolio to Government Stock and Semi Government Stock, whereas other jurisdictions are allowed to hold Covered Bonds and Supra Paper.
3. Extending the term of short term issuance. This has the effect of reducing our funding concentrations. For example, if all short term funding is issued at 90 days then we must refinance it every 3 months, but by issuing at 120 days or 150 days this reduces the amount of re-financing we need to do in any given month.

In general, changing the funding model to make it more stable comes at a cost that will be borne in part by borrowers, whilst investors will reap the rewards via higher deposit rates as their money is more valuable than is once was. Table 1 below covers the forecasted increase in our costs of funds.

Table 1 - Forecasted cost of funds

Asset Cost of Funds Rates (bps)	Forecast		Forecast				Forecast
	FY12		FY13				FY14
	Q3	Q4	Q1	Q2	Q3	Q4	Q1-4
Base COF	104	104	104	107	110	110	115
Cash Bills Recovery	16	13	13	13	13	13	13
Cash Plus Assets (CPA)	120	117	117	120	123	123	128

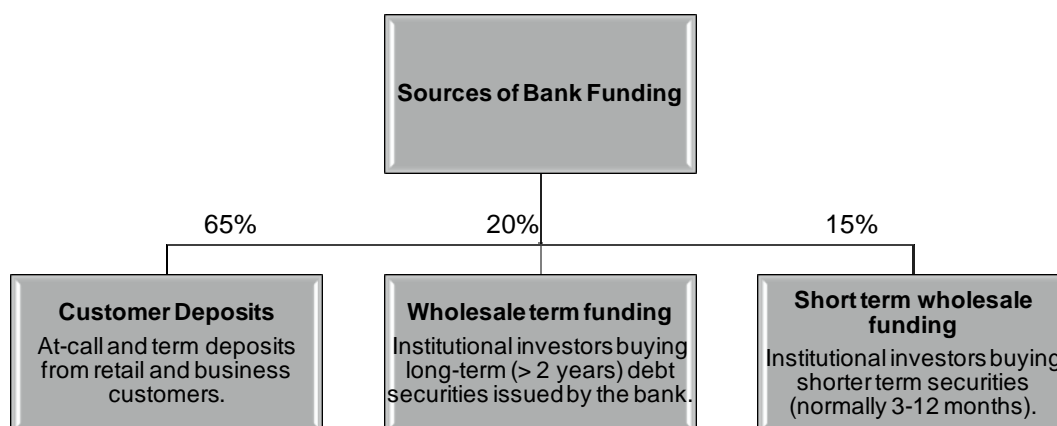
Lending and Funding

The current cost of funds for lending purposes

Committee members have expressed an interest in gaining a better understanding of funding practices for the banking industry and the implications for pricing decisions, the following information is provided for this purpose.

The following section outlines each of the sources of bank funding and analyses the impact on funding costs pre and post the financial crisis and over the past 12 months. An indicative overview of each of these sources and the proportion of core lending that is funded by each is shown below.

Chart 1 – NAB Sources of Funding (indicative)



NAB has almost \$400b of lending products including mortgages, credit cards, personal loans, business loans and lending to corporates. Approximately 65% of our funding for this lending comes from money deposited with NAB by our customers. 35% of our funds are sourced from the global wholesale market from large institutional investors such as investment funds, international banks and superannuation. Approximately a third comes from domestic investors and two thirds from overseas investors.

The RBA Cash Rate & our funding costs

Banks don't borrow money from the Reserve Bank of Australia (RBA) to fund lending. The RBA cash rate sets a base rate for the economy. Banks pay a premium for funding over-and-above the RBA cash rate, which is reflected in the wholesale market rate. The size of this premium fluctuates, depending on domestic and global market conditions.

Prior to the GFC, when there was greater stability in the global economy, the premium was lower, which meant that banks generally followed the direction of RBA Cash rate changes. Now that we are in a more unstable environment, banks are paying a higher premium for funding.

There remains speculation and misunderstanding of the role of the banks and the role of the RBA on setting interest rates and how the cash rate and monetary policy works more generally. Recently, there have been claims that the RBA has lost control of monetary policy, yet the RBA itself has rejected this suggestion on numerous occasions (most recently in its April Board Minutes and March Bulletin).

The RBA monitors bank funding costs closely and has validated that bank funding costs have increased relative to the cash rate. The RBA takes this, and retail interest rates on offer in the market place, into account when setting the cash rate.

Banks moving interest rates other than in line with the RBA is certainly unpopular with many borrowers (although welcomed by savers) but the RBA remains firmly in control of where interest rates sit.

Costs & access to finance

If Australian banks were to simply absorb all of these funding costs, it would limit the industry's ability to continue lending as much to home owners and small businesses.

At NAB, we are committed to lending people money to buy their first home, upsize, invest or even start a business:

- Over the past 35 months we have been able to maintain the position of having the lowest standard variable home loan rate of the major banks, while adding 10,000 new mortgage customers every month
- We're the largest business bank in Australia, and we continue to grow our market share – we currently have the leading business lending market share at 24.6%. We work closely with our customers to ensure they are able to take advantage of growth opportunities and manage challenges that may come their way in 2012.

Costs & NAB profits

NAB is working to manage increasing costs in a responsible way - doing the right thing by our customers, our workforce of more than 44,000 people worldwide, our shareholders, as well as the broader community.

Consistent levels of profitability from the Australian banks allow them to maintain an AA- rating (a measure from ratings agencies of safety and credit-worthiness). If the Australian banks continue to incur additional

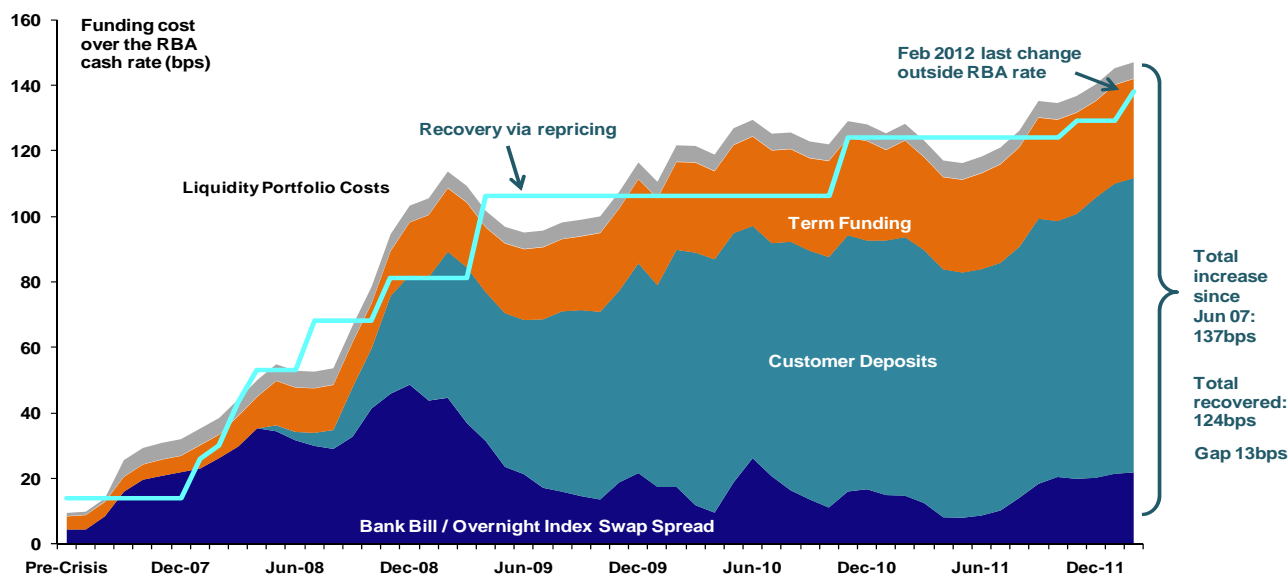
costs without passing them on to customers, this would impact profitability and ultimately lead to difficulty in securing wholesale funding, which would reduce the availability of credit in our economy, i.e. our ability to lend.

Our Funding costs have increased 137bps since Jun-07 vs. 124bps of mortgage repricing outside RBA rate changes. This is because:

- In the 5 months to Feb-12, overall funding costs have increased 13bps, primarily due to changes in term deposits costs and the Bills-OIS spread;
- The outlook is negative for the next quarter given increased term issuance and that 30-40% of the term deposit book has yet to reprice at elevated spreads;
- Given the current cost of these funding sources vs. returns on new lending, risk-adjusted incremental returns are marginal.

It was clear that during the recent volatility (FYQ1) in Europe locked us out of the term markets. Our customers also modified and reduced their investment/borrowing intentions because of this action in Europe. This was despite strong economic fundamentals in Australia with low unemployment, and high commodity prices. This demonstrates that when the rest of the world is in turmoil, Australia is not insulated.

Chart 2 - Funding cost over the RBA cash rate (bps)



Source: NAB Treasury & Bloomberg

For more information on our funding and deposit costs please see the attachment accompanying this submission ("*NAB Funding and Deposit Costs*").

Appendix 1 – Key Initiatives delivered under NAB’s Fair Value Strategy since Sept 2009

Fees & Charges initiatives - making our fees & charges fairer and simpler for our customers

- Abolished the overdrawn fee from everyday personal transaction accounts
- Abolished over-the-limit fee on credit cards and reduced late payment fee from \$30 to \$5
- Abolished monthly account service fees and transaction fees on our most popular transaction accounts
- Abolished dishonour fees and cash handling fees on business transaction accounts
- Abolished personal home loan switching and prepayment fees, reduced early exit fees and reduced or removal of a range of servicing and sundry fees.

Quality services & products initiatives - making our products and services safe, accessible and easy to use

- Upgraded an on-line hub to be a 'one stop shop' to help small businesses across all phases of their lifecycle and to better connect to bankers on-line
- Maintained lowest home loan standard variable rate of the major banks for the last 35 months and pledged to continue throughout 2012
- Formed and extended the RediATM network to increase the ATM network and free access to funds for NAB and credit union customers.
- Extended hours of the Customer Contact Centre to include weekends allowing customers to bank when they want.
- Refreshed www.nab.com.au with a more simplified and intuitive layout for customers to use and find information.
- Extended NAB mobile applications to provide more customers with greater access on a broader range of smart phones.
- Extended customer touch points through kiosks, mobile bankers, small business banker network and refurbished and better placement of stores.
- Made changes to credit card payment hierarchies resulting in lower interest payments for customers – a fair value credit card.
- Simplified the 13 22 65 menu making it easier for customers contacting NAB.
- Made NAB letters available on-line via Internet Banking allowing our customers to save correspondence electronically.

Compassion & support initiatives - having empathy and guiding on the best course of action for our customers and for us

- Launched Nab Care - a program to assist our personal and small business customers before they experience financial hardship
- Extended Nab Care to support customers in times of need during natural disasters including those impacted by floods, cyclones and bushfires

Help, guidance and advice - proactively sharing our expertise and helping, guiding and advising our customers about their money and what they are trying to achieve

- Introduced free SMS alerts for account balances, credit card payment reminders and funds transfer status updates
- Launched new On-line Help & Education sections of our web site to help our customers deal with different aspects of financial literacy and to better understand banking services and financial products.