

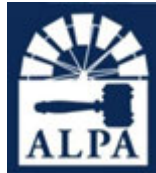


National Farmers' Federation

Submission to the Productivity Commission Inquiry into Competition in the Australian Financial System

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NFF Member Organisations





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.

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Executive Summary

The key priorities for NFF regarding lending to primary producers includes:

- Availability of debt finance from Authorised Deposit-taking Institutions (ADIs) and other non-ADI lenders
- The terms of debt finance from ADIs and non-ADI lenders
- The degree of competition in the provision of rural debt finance

Access to credit to purchase land and agricultural businesses, manage cash flow and expand operations is paramount to the farm sector, given the infrequent nature of payments for crops and livestock and other primary products. Also, food and fibre producers face significantly more volatility in incomes than other industries.

Since the height of the global financial crisis in 2009, annual growth in rural lending has all but collapsed, predominantly due to debt financing for operating expenses drying up.

Not only has operating debt finance been harder to come by, it has also become more expensive relative to other loans, since the Global Financial Crisis (GFC). This is a trend that has occurred for small and medium enterprises across the board, but since that time a gap has opened up between agribusiness overdraft rates and the rates on residential-secured small business loans.

The GFC had a wide ranging effect on the banking sector. In general, wholesale bank funding has been harder to come by, which has led to certain types of bank loans becoming harder and more expensive to access. There have also been a number of policy and regulatory changes that have impacted on agribusiness lending.

Although it is hard to discern accurately due to limited data, bank acquisitions that were allowed by the ACCC during the GFC are likely to have had a substantial impact on agribusiness lending in some markets.

There are some alternatives to bank overdrafts and other forms of revolving credit. However, these other forms of finance are likely to be more expensive than bank funding, once fees and other lending conditions are taken into account and they may not be able to be used at certain times.

FMDs enable farmers to reduce their reliance on debt finance, essentially through encouraging retention of previous earnings. While recent policy changes have been positive, there is room to improve the operation of the scheme.

1. Introduction

Our vision for Australian agriculture is to become a \$100 billion industry by 2030. The sector is a source of strength in the Australian economy, positioned to capitalise on growing global demand for safe, high quality food and fibre over coming decades.

To achieve our vision, the sector needs regulatory and public policy settings that foster growth and productivity; innovation and ambition. The key priorities for NFF regarding lending to primary producers includes:

- Availability of debt finance from Authorised Deposit-taking Institutions (ADIs) and other non-ADI lenders;
- The terms of debt finance from ADIs and non-ADI lenders;
- The degree of competition in the provision of rural debt finance.

Access to credit to manage cash flow is paramount to the farm sector, given the infrequent nature of payments for crops and livestock and other primary products. Also, food and fibre producers face significantly more volatility in incomes than other industries.

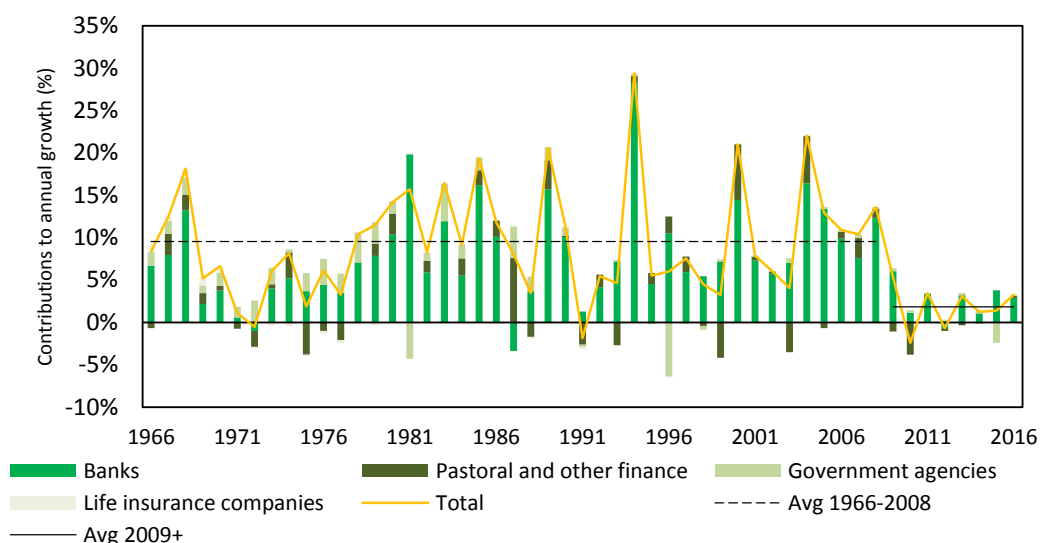
Farmers need to access credit to invest in, and improve, their productivity through adoption of new technologies and production methods.

There have been a number of trends that have emerged in rural lending in recent years, which are hampering the ability of farmers to utilise credit to manage their cash flows. These are discussed in section 2. Section 3 considers other developments that have impacted farmers' access to finance and section 4 discusses some alternatives to bank loans and why these are not necessarily an adequate substitute for bank lending.

2. Trends in rural lending

Since the height of the global financial crisis in 2009, annual growth in rural lending has all but collapsed. Figure 1 shows rural lending by source since 1966. From 1966 to 2008, rural lending growth averaged 9.5 per cent per year. Since 2009, it has only averaged 1.8 per cent.

Figure 1 Rural lending by type of institution



Source: RBA Table D09

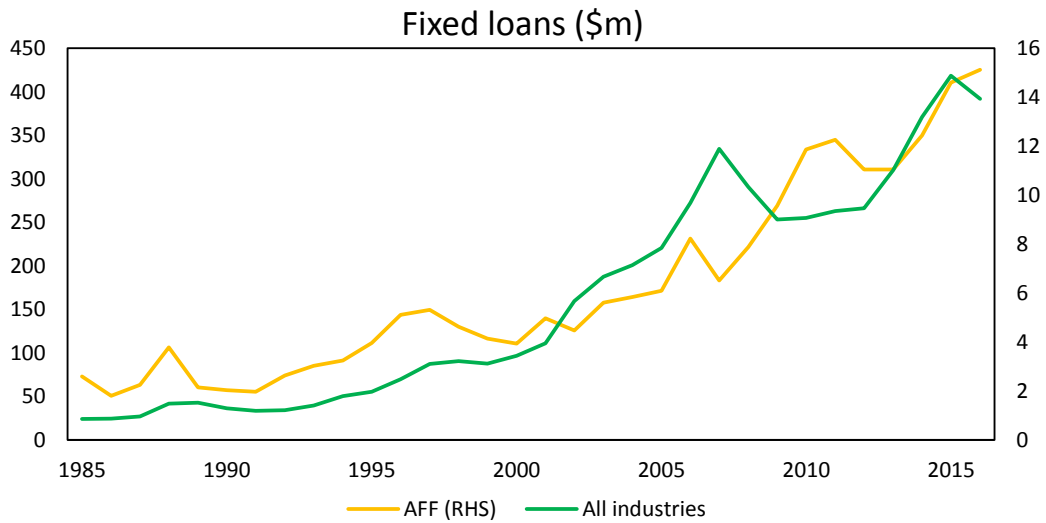
Breaking down rural lending by types of loans, it is immediately apparent that debt financing for operating expenses has dried up. This is a trend that has occurred across the board for businesses (small businesses, in particular), but the trend has been far more apparent in the agriculture, fishing and forestry sector.

Fixed loans have grown since 2009, both for the agriculture, forestry and fishing sector (average annual growth rate of 6.8 per cent) and the economy as a whole (6.4 per cent per year). In contrast, revolving credit for the agricultural, forestry and fishing sector has fallen by an average of 5.6 per cent per year, compared to an average fall of 0.3 per cent per year for all industries.¹

Figures 2 and 3 below show how fixed lending and revolving credit, respectively, have evolved over time.

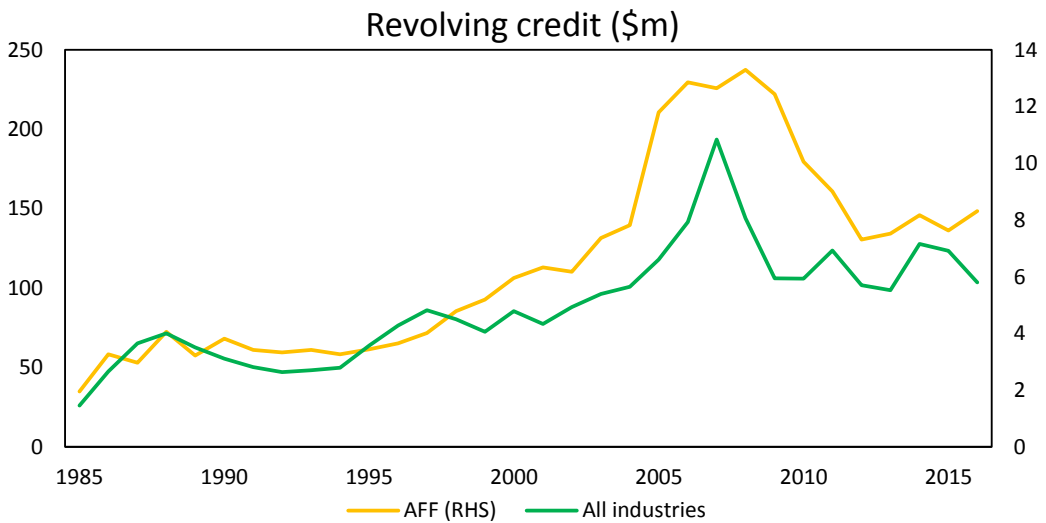
¹ Author’s calculations using data from ABS cat. No. 5671.0 Tables 17 and 18.

Figure 2: Fixed loans Agriculture Forestry and Fishing vs All industries (\$m)



Source: ABS Cat. No. 5671.0 Table 17

Figure 3: Revolving credit Agriculture Forestry and Fishing vs All industries (\$m)



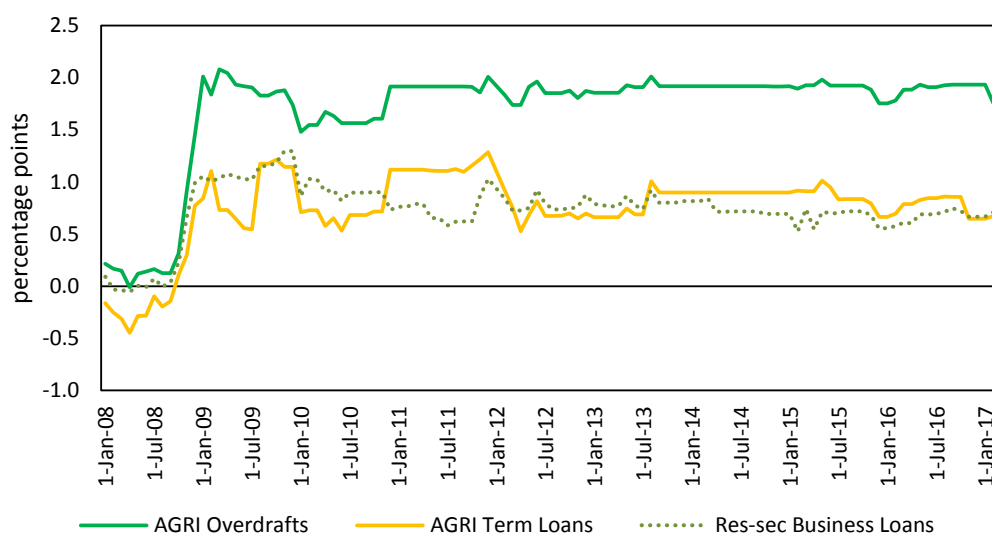
Source: ABS Cat. No. 5671.0 Table 18

Not only has operating debt finance been harder to come by, it has also become more expensive relative to other loans, since the GFC. Again this is a trend that has occurred across the board for small businesses. The gap between the Reserve Bank of Australia (RBA) overnight cash rate and all forms of lending has increased. However, the gap between Agribusiness overdrafts and the standard variable residential mortgage rate (standard variable rate) has blown out since 2009.

Prior to the GFC, the gap between the standard variable rate and agribusiness overdrafts was similar to the gap between the standard variable rate and residential-secured business loans. In more recent times, the size of the gap for agribusiness overdrafts has widened – as at March 2017, it was approximately two

and a half times the gap for secured business loans (and incidentally fixed-term agribusiness loans). This is shown in figure 4.

Figure 4: Gap to standard variable residential mortgage lending rate



Source: Canstar unpublished data, March 2017

These data are characteristic of a reduction in competition in the agribusiness banking sector, although it is hard to draw any causal links.

Ever since the GFC, it is readily apparent that the tier of lenders underneath the ‘big four’ banks have struggled to attract the same degree of wholesale financing, which would limit their ability to compete.

The NFF recommends that the Australian Prudential Regulation Authority (APRA), the Australian Competition and Consumer Commission (ACCC) and/or the RBA should regularly publish more detailed data on market share of agribusiness loans and FMDs so that competition in agribusiness lending can be monitored more readily.

3. Other developments in the agribusiness banking sector

The GFC had a wide ranging effect on the banking sector. In general, wholesale bank funding has been harder to come by, which has led to certain types of bank loans becoming harder and more expensive to access. There have also been a number of policy and regulatory changes that have impacted on agribusiness lending.

Since 2008, the banking sector has undergone a substantial rationalisation – in particular with the acquisition of BankWest by CBA and the merger of St George and Westpac. Although it is hard to discern accurately due to limited data, these transactions that were allowed by the ACCC in late 2008 are likely to have had an impact on agribusiness lending in some markets.

Neither of these transactions were opposed by the ACCC at the time. However, the ACCC did make some particular comments about agribusiness lending.²

First, general concerns were noted by the ACCC at the time around agribusiness lending and points of presence. In particular, the ACCC stated that:

*The ACCC considers that there are several banking products for which a **physical presence** is a **key determinant** of customer choice — namely transaction accounts, SME and **agribusiness banking**. Market inquiries suggested that customers take account of the physical presence of providers— the presence of a branch in a convenient location and the extent of the ATM network — in choosing between financial institutions for these products. [my emphasis]³*

Farmers tend to rely on a face-to-face services (not necessarily a ‘branch’ level of service) and so a declining number of face-to-face points of presence can indicate a reduction in competition. Data from APRA by remoteness reveal that in moderately accessible, remote and very remote areas the total number of face-to-face points of presence has fallen by an average of nearly 3 per cent per year.⁴

In addition to these general concerns, the ACCC noted that on a national level, agribusiness lending was not likely to be substantially impacted by either acquisition. However, this was not necessarily true of BankWest and St George (through its ownership of the Bank SA brand). The former had substantial coverage of the Western Australian agribusiness lending market and the latter had significant coverage of the South Australian agribusiness lending market. NFF would like to see an analysis of the impact of bank mergers on agribusiness lending and farm management deposits in the years after these transactions.

One positive development has been the announcement by the big four banks that they will remove non-monetary default clauses for small and medium business loans under \$3 million. This has come in response to the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) recommendation from the Small Business Loans Inquiry report (Recommendation 3)⁵. The original recommendation was for the abolition of non-monetary default clauses to apply to loans up to \$5 million and NFF urges the banks to consider that threshold.

² See the Public Competition Assessments, accessed 10 July 2017:

Westpac acquisition of St George:

<http://registers.accc.gov.au/content/index.phtml/itemId/839278/fromItemId/751043>

CBA acquisition of BankWest:

<http://registers.accc.gov.au/content/index.phtml/itemId/852882/fromItemId/751043>

³ Australian Competition and Consumer Commission, 13 August 2008, *Public Competition Assessment – Westpac Banking Corporation - proposed acquisition of St George Bank Limited*, p. 7

⁴ Australian Prudential Regulation Authority, 24 August 2016, *Points of Presence Statistics*, Table 2, accessed 10 July 2017, <http://www.apra.gov.au/adi/Publications/Pages/points-of-presence.aspx>

⁵ Australian Small Business and Family Enterprise Ombudsman, *Small Business Loans Inquiry*, p. 7, accessed 10 July 2017, http://www.asbfeo.gov.au/sites/default/files/030217-ASBFEO_Report.pdf

Recommendations 4, 5, 6, 7, 8, 9 and 10 from the same inquiry are also a high priority for NFF. These are:

- A minimum 30-business day notice period to all changes to general restriction clauses and covenants (except for fraud and criminal actions) be added to give borrowers more time to respond and react to a potential breach of conditions, (Recommendation 4);
- For loans below \$5 million, banks must provide borrowers with decisions on roll over at least 90 business days before loans mature, so borrowers can organise alternative financing. A longer period of time should be given for rural properties and complex businesses that would take longer to sell or refinance, (Recommendation 5);
- For loans below \$5 million, banks must provide a one-page summary of the clauses and covenants that may trigger default or other detrimental outcomes for borrowers, (Recommendation 6);
- For loans below \$5 million, banks must put in place a new small business standard form contract that is short and written in plain English, (Recommendation 7);
- All banks must provide borrowers with a choice of valuer, a full copy of the instructions given to the valuer and a full copy of the valuation report, (Recommendation 8).
- Every borrower must receive an identical copy of the instructions given to the investigating accountant by the bank and the final report provided by the investigative accountant to the bank. (Recommendation 9).
- Banks must implement procedures to reduce the perceived conflict of interest of investigating accountants subsequently appointed as receivers. This can be achieved through a competitive process to source potential receivers and by instigating a policy of not appointing a receiver who has been the investigating accountant to the business. (Recommendation 10).

These recommendations will ensure that banks are transparent in their dealings with farmers and provide adequate time for farmers to make alternative arrangements in the event of a breakdown in the lending relationship.

Over and above recommendation 8 regarding valuers, NFF recommends that banks should take adequate steps to ensure that valuers do not know the circumstances leading to the request for a valuation.

4. Alternatives to bank debt finance

In terms of operating finance, there are some alternatives to bank overdrafts and other forms of revolving credit. For example CBH offers a pre-pay advantage product which essentially enables grain farmers to receive pre-payment for their grain prior to harvest, however, farmers pay an access fee, interest and are locked into a particular price for their grain in advance.

Rural input suppliers such as Landmark enable grain and livestock farmers to borrow to purchase cropping farm inputs prior to harvest or use livestock as security to fund other input purchases, however, fees apply and it is necessary for farmers to take out insurance as well.

In short, these other forms of finance are likely to be more expensive than bank funding, once fees and other lending conditions are taken into account and they may not be able to be used at certain times.

Farm Management Deposits (FMDs) also enable farmers to reduce their reliance on debt finance, essentially through encouraging retention of previous earnings. NFF supported the increase in the limit for FMD accounts that an individual can hold from \$400,000 to \$800,000 and the removal of legislative impediments to financial institutions offering interest offset facilities based on those FMDs.

Currently, only one smaller bank offers an FMD interest offset facility and the major banks have indicated that their systems are not geared towards offering these products.

There are two aspects to this argument. One is that there does not appear to be sufficient competitive pressure for banks to offer this product. The other is that farm enterprises typically utilise a mix of business structures. Even a fairly small family-based farm operation can utilise a structure including partnerships, trusts and companies to ensure flexibility around succession planning, debt and risk management and limited liability advantages of companies. While the complexity of business structures mean that farmers can combine the advantages of each structure and avoid the pitfalls associated with them. However, that makes it difficult for financial institutions to offer these products.

NFF has previously advocated for FMDs to be allowed to be held at the entity level rather than the individual level, which would vastly simplify the matching of debt to the FMD holder.⁶

While this change would necessitate the development of tax integrity measures with respect to FMDs and possibly increase complexity of the tax system, NFF believes this is worthy of consideration.

⁶ National Farmers' Federation, *Pre-Budget Submission 2017-18*, pp. 30-31
<http://www.nff.org.au/submissions-search.html?categoryid=3673>

5. Conclusion

Access to credit to purchase land and agricultural businesses, manage cash flow and expand operations is paramount to the farm sector, given the infrequent nature of payments for crops and livestock and other primary products. Also, food and fibre producers face significantly more volatility in incomes than other industries.

Farmers need to access credit to invest in, and improve, their productivity through adoption of new technologies and production methods.

Since the height of the global financial crisis in 2009, annual growth in rural lending has all but collapsed. From 1966 to 2008, rural lending growth averaged 9.5 per cent per year. Since 2009, it has only averaged 1.8 per cent.

Fixed loans have grown since 2009, both for the agriculture, forestry and fishing sector (average annual growth rate of 6.8 per cent) and the economy as a whole (6.4 per cent per year). In contrast, revolving credit for the agricultural, forestry and fishing sector has fallen by an average of 5.6 per cent per year, compared to an average fall of 0.3 per cent per year for all industries.

Not only has operating debt finance been harder to come by, it has also become more expensive relative to other loans, since the GFC. Prior to the GFC, the gap between the standard variable rate and agribusiness overdrafts was similar to the gap between the standard variable rate and residential-secured business loans. In more recent times, the size of the gap for agribusiness overdrafts has widened to around two and a half times the gap for residential-secured small business loans.

NFF recommends that APRA, ACCC and/or the RBA should regularly publish more detailed data on market share and pricing of agribusiness loans and FMDs by State and Territory so that competition in agribusiness lending can be monitored more readily.

Farmers tend to rely on a face-to-face services (not necessarily a 'branch' level of service) and so a declining number of face-to-face points of presence can indicate a reduction in competition. Data from APRA by remoteness reveal that in moderately accessible, remote and very remote areas the total number of face-to-face points of presence has fallen by an average of nearly 3 per cent per year. This is of concern to NFF.

Since 2008, the banking sector has undergone a substantial rationalisation – in particular with the acquisition of BankWest by CBA and the merger of St George and Westpac. Neither of these transactions were opposed by the ACCC at the time.

The ACCC noted that on a national level, agribusiness lending was not likely to be substantially impacted by either acquisition. However, this was not necessarily true of BankWest and St George (through its ownership of the Bank SA brand). The former had substantial coverage of the Western Australian agribusiness lending market and the latter had significant coverage of the South Australian agribusiness lending market. NFF would like to see an analysis of the impact of

bank mergers on agribusiness lending and farm management deposits in the years after these transactions

The announcement by the big four banks that they will remove non-monetary default clauses for small and medium business loans under \$3 million in response to ASBFEO recommendation 3 from the Small Business Loans Inquiry report is a welcome development. NFF would like to see the banks comply fully with the recommendation 3 in the ASBFEO report, along with recommendations 4, 5, 6, 7, 8, 9 and 10. These recommendations will ensure that banks are transparent in their dealings with farmers and provide adequate time for farmers to make alternative arrangements in the event of a breakdown in the lending relationship.

Over and above recommendation 8 regarding valuers, NFF recommends that banks should take adequate steps to ensure that valuers do not know the circumstances leading to the request for a valuation.

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Currently, only one smaller bank currently offers an FMD interest offset facility and the major banks have indicated that their systems are not geared towards offering these products.

NFF has previously advocated for FMDs to be allowed to be held at the entity level rather than the individual level, which would vastly simplify the matching of debt to the FMD holder. While this change would necessitate the development of tax integrity measures with respect to FMDs and possibly increase complexity of the tax system, NFF believes this is worthy of consideration.