

# The National Australia Bank and Corporate Culture

Evan Jones  
Political Economy, University of Sydney

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The National Australia Bank has for several years experienced a series of large scale mishaps, involving often substantial losses but always a continuing dent in its reputation.

Ten years ago, the NAB was Australia's biggest bank. It commanded respect; investors rushed to its share register; it commanded fear as it threatened takeovers (the second tier St. George Bank was vulnerable for a while). Under Chief Executive Officer Don Argus, the Bank had a vision of global status, expanding into Britain and North America, and poised to further enhance its dominance of the domestic market.

Rapid growth overseas was a key plank of expansion, not least to offset the impasse on domestic market scale under the 'four pillars' policy. The expansion of NAB into the US through NAB branches (the largest Australian bank network with assets of \$4 billion in 1989) in the 1980s generated consistent losses until closure of the network in the early 1990s. The subsequent move was to expansion through acquisition, and there are divergent views on the success of this process. One view is that the acquisition process was soundly based, with emphasis on countries with relatively common institutional structures, sensible prices paid, and appropriate due diligence performed (Mackenzie, 2001). The acquisition of the Bank of New Zealand in 1992 and Michigan National in 1995 is arguably a reflection of this process. Yet a decade later, the bank possessed an agglomeration of subsidiaries with different operating systems and facing variable environments. One commentator has claimed that the British banks were managed inappropriately, one key reflection being a turnover of Australian personnel sent to Britain then recalled on their way up an Australian-centred promotion ladder.

The process of expansion overseas is one dimension of a transformation that has been poorly managed. The status of the early 1990s has gone. John Sevier, head of equities at Perpetual Trustees claimed in June 2004 at a conference of superannuation investors that in the NAB 'there was a phenomenal arrogance, even with a deteriorating operating performance' (Gluyas, 2004). At the annual general meeting in November, new CEO John Stewart had appropriated the criticisms as his own, claiming 'NAB was in a state of self-delusion, where people started believing their own propaganda, that the bank was the biggest and the best and these were small problems that would go away' (Murray, 2004).

The fact that revenues continued to be sizeable may have contributed to the Bank's (and the market's) complacency. The *Financial Review's* Anthony Boyd has commented that, over the last 25 years, 'a major banking licence has been a licence to print money thanks to the industry's oligopoly structure, the high margins from home lending, the efficiency gains from technology, decades of credit growth faster than GDP growth and the easy with which capital was raised to fund expansion' (Boyd, 2004a). Boyd quotes

a fund manager to the effect that ‘an idiot could run a major Australian bank and still make money’. In short, NAB’s success has been a product of market power and a serendipitously favourable environment rather than purely of strategic capacity.

The series of large scale problems have involved disputes both with suppliers and clients, and problems with administration. A bank analyst from JP Morgan was reported in January 2004 as claiming that the NAB had generated fourteen ‘evil sins’ under CEO Frank Cicutto (Cornell, 2004a). The staid conservatism of the bank was still in evidence under ‘Nobby’ Clark (who declined to get the NAB involved in foreign currency loans to small business) and Don Argus, but these two over-revered CEOs gradually put in place a regime that Cicutto inherited and reinforced.

Andrew Cornell, a *Financial Review* banking journalist, has noted that ‘the major blunders are each in their own way different, but the disturbing thought is that their very disparity could reflect a deeper malaise’. Cornell has claimed astutely that the Bank’s problems ‘are cultural, not just particular. They stretch back a long time and they are fundamental’ (Cornell, 2004b).

The most significant of the NAB’s recent problems are summarised below.

## **Large-scale problems**

### Receivership of the Bell Group

In April 1991 a consortium of banks including NAB put a Bell Group subsidiary, Bell Publishing, into receivership. As a consequence, the entire Bell Group was forced into receivership. Given that the Bell Group of companies was under the control of the hubristic, incompetent and corrupt Alan Bond, the banks’ action would appear entirely predictable and reasonable. It is the peculiar character of the receivership, however, that has brought the action back into the courts and into the public gaze. Bell’s liquidators resurrected the issue in 1995, to be fought under the insolvency provisions of the Companies Code, and it has only just reached court in July 2003 where the action is still pending.

By late 1989, the NAB’s exposure to the Bell Group was estimated at \$600 million. Lending by the newly deregulated banks in the late 1980s was generally characterised by excessive amounts, to the wrong people (the ‘white shoe brigade’) and in the wrong form. Much lending was unsecured; the ‘negative pledge’ was a common convention in which borrowers pledged not to give security over assets to their other borrowers. Bond’s companies ended up with a massive debt, inadequately secured or unsecured, from a multitude of banks, both domestic and foreign.

When the issue went to trial in July 2003, the receiver’s counsel Ross Robson noted that the taking of security by the banking consortium was not a means to rebuilding the group as the group was already effectively insolvent. Indeed, the NAB had led the move to put Bond brewing assets into receivership only several weeks previously in December 1989. Neale Prior of *The Age* reported that (Prior, 2003):

Mr Robson said within days NAB had, however, agreed to extend already-troubled loans to another Bond company, Bell Group, and leave these same men in charge of Bell companies in return for sweeping mortgages over key assets. Mr Robson said NAB and its fellow banks involved with Bell Group were not concerned with normal banking practice but wanted to get security over Bell assets and keep the company going long enough to reduce challenges to the mortgages.

Curiously, six months later (when the January loan extension had expired) a group of Bond bankers enjoyed a celebratory lunch in an expensive French restaurant in London.

According to Robson (Drummond, 2003):

[The 1990 refinancing deal] had nothing at all to do with having confidence in the expertise and commercial acumen and judgement of Mr Bond, Mr Oates and Mr Mitchell. Just pure, cold, hard cash. Instead of the banks being motivated by any consideration of what was right and wrong, what was the law and any principles of proper corporate governance ... the banks were motivated by the fact that, well, even if we do the wrong thing, the worst that can happen is we have to give the money back. [But] they have kicked and fought and scratched and punched all the way here.

There is smoking gun evidence implicating NAB. An NAB memo of January 3 1990 intimates that Frank Cicutto declared himself initially reluctant to pursue taking security because of the immediately previous action in putting Bond brewing into receivership and because of fear of adverse publicity. Cicutto was warned of competing claims on assets by junk bond holders and he subsequently participated in the process (Drummond, 2003).

Taking security enabled the banks to gain \$280 million after liquidation, leaving other creditors with nothing. The liquidator is now suing for the return of the \$280 million at present value, estimated to be \$1.4 billion. Continuation of the trial depends on the continuing funding of the liquidator by the State Insurance Commission, backed by the Western Australian Government. The banks have counter-sued against the Commission and others.

The Robson interpretation of bank motivation is a rare articulation from the legal profession of an important plank in a bank's armory. It is known from evidence of the NAB's behaviour in putting small businesses into receivership that the manipulation of securities is standard practice.

#### The Maconochie affair

In 1996, the NAB got involved in a joint venture with a company founded by one John Maconochie to develop e-commerce initiatives. By 1999, Maconochie was suing the NAB for \$32 billion. As Stephen Mayne noted, 'it is the largest commercial claim against any Australian company in Australian history' (Mayne, 2000). It transpires that the agreement had included a sizeable annual fee and revenue-linked royalty for the use of Maconochie's intellectual property, that an absolute guarantee had been given regarding future payments, and that NAB had subsequently moved its e-commerce activities into a separate vehicle. The NAB resorted to the banks' conventional practice

of grinding the litigant into penury rather than confront the substance of the issues at litigation. Maconochie was able to persist with litigation longer than a typical small plaintiff because of outside backing. The Maconochie litigation is estimated to have cost the NAB \$70 million in legal fees. NAB lawyers Freehills claim that NAB won the case on substantive matters (that is, Freehills won the case for NAB), but the court dismissed Maconochie's case because his backers could not provide security for NAB's further legal costs.

### The integrated systems implementation failure

In late 1999 NAB initiated a project to streamline its personnel and general ledger administration via an integrated software structure. The bank confidently expected the initiative to cost \$200 million and that implementation would be relatively straightforward. The bank immediately started capitalising its expenditure (treating its expenditure as capital assets) as if implementation was a *fait accompli*. The bank hadn't confronted the massive structural reorganisation necessary for successful implementation.

NAB had purchased a number of banks in England, Ireland and the USA, all with their own operating systems. Reputedly one of the reasons why NAB found the purchase of Michigan National an attractive proposition was that Michigan National was believed to be on the same technology platform as one of NAB's UK banks Clydesdale. It turned out that both banks were supplied by the same software company, but with different and incompatible software.

German software provider SAP, like its competitors, presumed it was offering off-the-shelf software; made to measure integration was not part of the package. The implementation of ISI was being managed externally by Deloitte, but brought inside in early 2002. By March, the project that was initially estimated to cost \$200 million had a \$800 million price tag on it. Part of the blowout was due to the extraordinary outgoings on expensive consultants to discover and remedy the problems. Deloitte subsequently sued NAB for \$38 million in unpaid fees; there was a confidential settlement in September 2002.

An insider commented in 2002 (Cornell, 2002):

... the problem is a management one. It's internal politics and setting expectations of outcomes and deliverables which were never realistic and could never be met and then putting management in place who had no IT or program management experience. There were very unrealistic business, cost and revenue goals. The ISI project was given its objective and time frame before the project commenced. There was and is no knowledge of what can be achieved and when.

NAB's 2003 balance sheet carried \$955 million of capitalised software, of which \$315 million related to the ISI project. The bank wrote off \$400 million in software 'assets' in its 2004 annual report, including the \$200 million ISI expenditure as 'fully impaired'. The prospects are for further write-offs of expenditure associated with ISI.

### The HomeSide losses

HomeSide is an American mortgage processor. NAB decided to buy HomeSide for \$1.7 billion in October 1997. The presumption was that its technology would deliver savings of over 1% on a standard mortgage, not least because it was expected that NAB mortgage lending across all its banks could be delivered from a common platform. With the announcement on the 24 January 2000 that Melbourne would be the preferred head office for HomeSide, Mr Cicutto claimed: 'This is another example of the National utilising its global business lines to derive benefits for its Australian and international customers and investors' (National Australia Bank, 2000).<sup>1</sup> Cicutto is praising the initiative, but the HomeSide purchase was a Don Argus decision.

Stuart Mackenzie, sometime NAB Treasury officer, provides a penetrating insight into the HomeSide story (Mackenzie, 2001; 2002a; 2002b). Argus knew well and was impressed by an aggressive American banker and bank acquirer called Hugh McColl. It turns out that McColl was offloading HomeSide after an acquisition and Argus paid a high price. It appears that goodwill constituted 65% of the \$1.7 billion purchase price.

HomeSide was not just or predominantly the owner of a technology for mortgage processing. It also dealt in 'mortgage servicing rights', a vehicle for securitising in block amounts the mortgage indebtedness of primary mortgage lenders. But in the US, home mortgages are constantly re-negotiated when interest rates change. As for the innate difficulties of the business, HomeSide reported to the American regulator, the Securities and Exchange Commission (Mackenzie, 2001):

... the value of the mortgage servicing rights tends to diminish in periods of declining interest rates and increase in value in periods of rising rates. This tendency subjects HomeSide to substantial interest rate risk. ... The risk management instruments used have characteristics such that they tend to increase in value as interest rates decline. Conversely, [they] tend to decline in value as interest rates rise. Accordingly, changes in the value of these hedge instruments will tend to move inversely with changes in value of HomeSide's mortgage servicing rights.

The technology was not well tried but relatively new and extremely complex. Entry errors, wrong assumptions on interest rates and related hedging mistakes overlaid an unexpected and large-scale change in the environment – a persistent drop in interest rates during 2001 and a collapse in the market for bulk sales of mortgage servicing rights.

In July 2001 NAB wrote off \$568 million of HomeSide's value. At the time, Cicutto intimated that this sacrifice had cleaned out the bugs. Said Cicutto (Dow Jones, 2001):

I am comfortable that this asset is now recorded as a sustainable realistic value. ... We have decided to act decisively to address this area to ensure HomeSide is on a sound financial future going forward.

Cicutto was evidently ill-informed. Two months later, the losses were mounting. Total losses ultimately exceeded \$3.6 billion. HomeSide was sold off to another American

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<sup>1</sup> The decision to locate HomeSide in Melbourne was later reversed, but the announcement did provide the opportunity to bring onside the Premier, Steve Bracks (who makes further appearances later), with the prospect of job creation in Melbourne.

mortgage processor in two stages in December 2001 and September 2002. A capital gain was made on the sale, but it did not offset the substantial losses from operation.

The losses blew out because HomeSide operated from Florida without internal risk management procedures and (contrary to formal NAB procedures) without oversight from Australia. Even a NAB-ordered report confirmed this absence (National Australia Bank, 2002). HomeSide management insisted on autonomy, and Head Office acquiesced. Argus, Cicutto and Chief Financial Officer Richard McKinnon served on the HomeSide board but apparently without substantive input.

The NAB was simultaneously going through a formal process of tightening its risk management procedures after the core business of HomeSide was discovered to be in trouble. However the person hired to head Risk Management from July 2001, Christopher Lewis, had previously worked for KPMG as external auditor of the HomeSide accounts. Indeed, as Stephen Mayne pointed out (Mayne, 2001):

Crikey can now inform the public that this is the same Mr Lewis who was sent to Florida at the time of the Homeside acquisition to head a KPMG due diligence team that recommended the deal to the NAB board. He then became the auditor who didn't blow the whistle on it in the 2000 accounts and now is the guru managing global risk for the bank. Since he joined in July, they've pulled a \$3.6 billion loss out of the hat.

The three senior executives who were sacked in September 2001 (chief executive Hugh Harris, chief operating officer Kevin Race and chief financial officer Blake Wilson) were given collectively US\$4.65 million (\$8.3 million) in termination payments in June 2002 (Lekakis, 2002). The payments were a settlement designed to counter a claim by the executives for entitlements. Before the collapse, HomeSide executives were the highest paid individuals in the NAB's operations. Former chief executive Joe Pickett, received \$5.82 million in 2001, while Harris, then chief financial officer, received \$5.6 million.

In early 2003, the NAB was sued in the US by two NAB securities holders, who were also seeking to build a class action. The plaintiffs claim that NAB issued a series of 'material misrepresentations to the market' between April 1999 and September 2001, disadvantaging those who purchased NAB shares during that period.

#### Illegalities at NAB's Irish subsidiary

The NAB's Irish subsidiary, National Irish Bank, was discovered in 1998 to have been evading taxation and overcharging its customers (through both interest rates and fees) for at least the last ten years. Interest rates were changed to incorporate and hide non-interest administrative costs. However, no system was in place to account for administration costs. The NIB 'used bogus non-resident accounts and opened accounts in fictitious names to facilitate tax evasion'. A six year investigation by two inspectors of the Irish regulatory authority appointed by the High Court reported (in a 400 page report) in July 2004. The authority's Director noted 'the report is deeply disturbing in revealing the extent to which illegality and bad practice was tolerated (and to some extent encouraged) within the organisation between 1988 and 1998' (Boreham, 2004). Admittedly, the report noted that the creation of illegal non-resident accounts for tax

evasions was an industry-wide phenomenon at the time; but NIB had set up a division in 1989 to advise customers on investment, and this division was a key vehicle for directing ‘hot’ money into illegal accounts.

The report faults the bank’s culture (cited in Boyd, 2004b):

‘The branch network was target-driven. There were, amongst others, targets for fee income and deposits, but limited support by way of systems of training to enable the achievement of these targets. ... Managers felt under pressure to meet these targets, in the setting of which they had negligible participation and which many considered unreasonable; they feared criticism and possible humiliation before their fellow managers if they did not meet the targets set’.

The report (and confirmation by the Irish High Court) contradicts previous claims in 1998 by the then NAB CEO Don Argus. These practices occurred under the watch of Argus. Argus claimed support for his counter-claims from an independent (NAB sponsored) investigation. This investigation was conducted by the now defunct accounting firm, Arthur Anderson, which was dissolved after the exposure of dishonesty in its auditing of Enron. Argus claimed that the NAB brand had been severely damaged, and the public broadcaster Radio Telefís Éireann was sued for libel. The inspectors deemed the Anderson report inadequate, and the High Court ruled that the broadcaster allegations were essentially accurate (Rogers, 2004a; 2004b).

The NAB incurred costs of \$110 million in tax payments, customer remissions and administrative costs.

#### The MLC unitholders failure

NAB bought the MLC, one of Australia’s handful of insurance giants, for \$4.56 billion in April 2000, assuming control in June. The CBA paid over \$9.1 billion for Colonial, of which \$4.47 billion was for the wealth management entities of Colonial. The *Financial Review*’s Stewart Oldfield claimed that the NAB purchase of MLC ‘[set] the benchmark for expensive wealth management assets’. NAB paid a record 22.8 times earnings for MLC, and then faced a downturn in the equity market (Oldfield, 2003).

In mid-2001, NAB integrated its own wealth management operations with the MLC business. In seeking to rationalise offerings, NAB closed some products to new investors, resulting in a substantial flow of funds to MLC products. An adjustment in unit prices was implemented in October to cover higher per unit transactions costs, as per policy (it is not clear in which products the reduction in unit price occurred as the process has never been adequately explained publicly).

Complaints from investors and advisers led to NAB deciding in August 2002 to make good the losses to investors, then estimated to be about \$60 million. Intense if belated interest was shown by ASIC and APRA in the event because of its broader ramifications for equitable product pricing and the duties of trustees. By September 2003, agreement was reached that \$67.2 million would be paid in compensation for some 215,000 investors (for many the sums were trivial, but the compensation summed in the thousands for others).

No malintent on the part of NAB was involved, but NAB did display a naivete and incompetence in the administration of its new expanded arena of wealth management. Further, NAB showed indifference to an explanation to effected parties until prompted by complaints.

### The dealing room scandal

In January 2004, it percolated to the surface that a group of options traders had run up sizeable losses over several months speculating that the Australian and New Zealand dollars rising against the US dollar would run out of steam. However, the two currencies kept rising. Apparently the NAB board was led to believe that the Australian dollar would keep rising, and members thought wrongly that their traders were acting on the same belief. The loss and its scale took time to surface (belatedly estimated at \$360 million) because the traders had been hiding their losses through fictitious trades. Profits from other foreign exchange transactions were reallocated to hide the losses. In order to recoup their losses, the traders ignored the stop-loss trading safeguards (which dictate that losses will be truncated by being crystallised once prices reach a certain level).

Equally as significant, there was no independent back office monitoring trades. The global head of foreign exchange, Gary Dillon, had apparently wanted to absorb the typical functions of back office, and senior management had accommodated him. The lack of back office controls and managerial oversight was common to previous large scale foreign currency scandals (as with Nick Leeson trading out of the Singapore office of Barings). The failure of NAB to establish and maintain back office independence is inexcusable (Clow, 2004).

The ANZ bank had approached NAB in March 2002, having noticed aggressive trading and irregularities; the bank was rebuffed with NAB threatening a loss of business between them. APRA did a small investigation in 2003 with little effect.

The trader's supervisors were of [breaches in the value-at-risk limits] but ignored them. The bank's risk management group and internal audit function raised warnings about the breaches of the limits and NAB's policies but didn't pass them up to the CEO and board. [APRA] identified some of the risks, but the board and senior management received a sanitized version of the regulator's concerns and reassurances that the matters weren't significant and were being responded to. The board was given, it appears, edited and sometimes misleading information about the risks being taken – to the extent it was informed at all. ... Both Stewart and PwC say good news travels up the line quickly in NAB but bad news is suppressed. That's an indictment of the senior management (Bartholomeusz, 2004).

A disgruntled client is of the opinion that 'lack of skill' in currency trading predated the currency losses of 2004. Trevor Korn, a cattle-hide exporter, is currently in the courts with a \$1 million plus claim against the NAB because of its alleged incompetence in managing his foreign exchange exposure. Korn claims that the dealers told him to terminate some sell and buy contracts in early 2000 on the strength of the likely rise of the Australian dollar, which involved the unnecessary crystallisation of losses for Korn. Korn claims that bank staff advice was driven by the desire to protect their own position (Oldfield, 2004f).

The dealing room losses constitutes a major scandal. The bank's top brass initially acted as if they were going to discount the phenomenon as of ephemeral significance; but ultimately both the CEO Frank Cicutto and the Chairman, Charles Allen, fell on their swords. Other banks knew of the NAB's excessive exposure; one of the traders claimed that senior management knew of the breached trading limit; the bonuses granted the traders were sizeable. In short, the losses were not a product of 'rogue' traders but of a rogue bank that had thrown caution to the winds.

Senior management might be excused for thinking that the fuss would blow over. Financial deregulation in Australia had created the ideal conditions for currency dealing losses and fraud – hubris, incompetence and a light to non-existent regulatory apparatus. Dealer room scandals had emerged previously in the Commonwealth Bank, Westpac and the Bank of Melbourne, but generally they have been hushed up. Only the whistleblowers have suffered adverse repercussions. Why shouldn't NAB have a flutter as well?

The one difference in the environment for the NAB is that the Australian Prudential Regulatory Authority had been forced to find an issue to make its presence felt. APRA had been embarrassed by its ineptitude over the failure of HIH Insurance, and the NAB was to be the whipping boy for APRA's attempt at respectability.

The APRA report, released on March 24, noted that the NAB joint foreign exchange heads 'circumvented the formal recruitment process in engaging the currency options team in 1998 and 1999. Also, although a performance appraisal for one of the dealers identified excessive risk-taking as a concern, no action was taken'. Traders move in herds; Gary Dillon, global head of foreign exchange, had moved over from the Commonwealth Bank, and brought two of his four NAB traders with him from the CBA. The reputation of the CBA currency desk had not been unblemished.

#### Sophisticated debt packages and tax minimisation

In February 2004 NAB was hit with a claim from the Australian Tax Office of \$157 million in back taxes and \$150 million in penalties. In 1997, NAB raised US\$1 billion from US investors. The peculiar securities, labeled 'ExCaps', were invented to be treated as equity for accounting and regulatory purposes but to be treated as debt to gain tax deductions. The ATO's demand for back taxes and penalties relates to deductions gained by NAB between 1997 and 2000. The difference in annual profits is estimated to be of the order of \$39 million. The NAB immediately challenged the ATO decision.

The ATO was also separately considering the legitimacy of deductions claimed after 2000 on ExCaps (another \$135 million), and deductions on US\$450 million raisings in another form of hybrid equity called TrUEPrS in 1998 (\$101 million). The NAB appears to have a supporter in the Department which formally oversees the ATO, the federal Treasury. Treasury has indicated that it would support interest deductibility on these instruments after 2000 and up to 2006. The matter appears to be pending.

#### Northern Ireland subsidiary robbery

NAB owns a subsidiary in Northern Ireland called Northern Bank. On December 20, a raid on central Belfast branch netted what was then estimated to be \$51 million in bank notes. The raid, in character for Northern Ireland, involved the raiders being admitted to the bank's vaults while the families of senior staff were held as ransom. A subsequent audit has expanded the figure to \$67 million (Boyd, 2005). The Northern Bank and the National Irish Bank are in the process of being sold to a Danish bank for a reputed profit of \$1.1 billion. This capital gain (serendipitous?) provides a positive background to yet another claim by NAB that the loss from the robbery is inconsequential.

## **Other aspects of risk management**

Some of the larger debacles outlined above are a product of poor risk management, by definition. However, some vignettes add to the picture.

How well has the loans book been managed recently? One substantial failure of procedures is indicated by loans totalling \$109 million to a regional business company owned by Peter and Anthony King. As part of this total, a South Australian NAB State manager dispensed a \$44 million loan to the Kings for their bus fleet only to later discover that the fleet was owned by two finance companies. King Brothers company collapsed in 2002 with debts of over \$200 million, with the NAB having to write off a substantial part of its loan (Hills, 2004).

The bank had also had an exposure of \$263 million to the Sydney Airport (railway) Link, a monument to excess expectations. This exposure had been sitting in the books as non-accrual, and in October 2004 APRA required the bank to downgrade the exposure to a bad debt.

There is also the matter of fraud by bank employees. Employee fraud is a persistent problem for all banks. The case of the Commonwealth Bank branch manager stealing approximately \$19 million from his branch in the early 2000s is representative of the phenomenon. In this case, the branch's location in Karratha in the far north of Western Australia may have contributed to the length of the practice.

The NAB has not been immune. To feed a 'comfort shopping' addiction following a failed marriage, NAB employee Catherine Asley stole \$1,126,000 from her Dandenong South Victoria branch from 1994 onwards and covered it up by creating false accounts. The thefts continued over a four-year period without being uncovered. Keith Benning, business banking manager at Kilmore Victoria, stole \$5.7 million between 1998 and 2002 to feed a gambling addiction. NAB reimbursed a major business victim of Benning's fraud. However, the bank declined to take responsibility for negligently processing, at the Sale Victoria branch, cheques forged by a firm's corrupt accountant; NAB bankrupted the firm instead (of which more below).

## **The Cicutto era**

Frank Cicutto, a long-time NAB employee risen through the ranks, had been CEO since 1999. In 2001, he launched the strategy 'Positioning for Growth'. PFG emphasised

cost cutting and, with measures to increase revenue, aimed for substantially increasing earnings in 2003 and after. Two aspects of the cost cutting program involved the further centralisation of administrative structures in business banking and a reduction in exposure to 'higher-risk' customers. Front line staff were cut, and the small business loan book in particular was hit. Gottlieb (2004) claims that the centralisation was not accompanied by restructured linkages that facilitated functioning management on the front line.

The determination of what constitutes the bank's higher-risk categories appears to have been dubiously performed. Moreover, the shedding process, reported as involving about \$3 billion in loans, also appears to have been dubious. Victimization of some small business clients occurred, and the protests have been treated cavalierly to brutally by the bank. This process was inadequately covered in the financial media.

The 'vision' behind Positioning for Growth was the ubiquitous management consultancy McKinsey & Company. McKinsey personnel are the reputed experts of the big picture and revolutionary top-down change; in this case their strategy flopped badly.<sup>2</sup>

It also appears that NAB had also been seconding staff from KPMG, its external auditor, from 2001 onwards to help determine the value of 'distressed' loans. This abuse of the desired maintenance of arms-length relationship with auditors has been met cavalierly by Australian regulators and commentators. The NAB moved KPMG employees out of internal operations only after the US Securities and Exchange Commission expressed concern. The Sarbanes-Oxley Act, passed in 2002, proscribes auditors from performing a range of non-audit duties (especially Section 201).

There appears to have been a significant divergence between the bank's expectations regarding its strategies and the results with its customers. Not just small business lending was in trouble. In early 2003, even some of the top 500 companies were finding the NAB (as well as Westpac) less appealing as providers. The companies were reported as claiming that the banks thought that aggressive marketing and wining and dining the customers constituted good service, with the bread and butter closer relationships being neglected (Wilmot, 2003).

For two and a half years until the end of 2003, balance sheet provisions for bad debts were reduced almost from \$2.98 billion by almost \$750 million, in spite of 13% growth in loans and acceptances over the period (Oldfield, 2004a). With NAB not matching earnings growth of other banks, it appears that NAB may have been reducing provisioning to maintain appearances and to maintain its dividend payout. By early 2004, analysts were questioning the utility of the bank's accounting.

During 2002 and 2003, NAB outlaid \$2.7 billion to buy back shares; expert opinion was that this was a vehicle to keep the share price up to enhance the prospects of acquiring St. George Bank. NAB finally offloaded its 9% holding of St. George in early 2004.

In the midst of this atmosphere, Cicutto launched another strategic vision in August 2003 under the rubric 'growth through relationship excellence'. The heralded task was

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<sup>2</sup> Gladwell (2002) provides a comprehensive indictment of the McKinsey ethos, manifest in McKinsey's contribution to refashioning the flawed culture of Enron and contributing to its dramatic demise.

the creation of ‘balanced stakeholder relationships’ (Durie, 2003). That this might have been a tall order is highlighted by the division of labour – a ‘high-performance culture taskforce’ to improve both the workplace and customer service, a team to further maximise shareholder returns (under Chief Financial Officer Richard McKinnon whose reign was anything but illustrious), and a team focusing on further acquisitions to ‘deliver the best portfolio mix’.

One prospect for acquisition was the National Bank of New Zealand, subsequently acquired by ANZ. The acquisitions mentality, almost at any cost, was best embodied in the purchase of AMP shares in August, while AMP was in difficulty. NAB was apparently seeking about 15% of AMP. The attempt was frivolous, and a substantial diversion from ongoing problems.

For this kind of banality Cicutto received in 2003 the highest salary package within Australian banking – over \$7 million. When Cicutto resigned in February 2004 following the foreign currency debacle, he received a package of \$19 million, including a \$3.27 million terminating payment. Additions included company financed counseling on finding a new job as befitting his capacities, and a \$75,000 global tour to say goodbye to his empire (Short, 2004).

The reporting of the 2003-04 half year results in May 2004 provided grist for more media attacks on the Cicutto years. Crikey.com commentator ‘Terry Teller’ (Teller, 2004) claimed that the Cost to Income ratio was 50.9%. The cost to income ratio is the index that appeals to analysts because it simplifies inter-bank comparisons and also neglects the substantive qualitative character of banking. The ratio had been 47.3% a year earlier, but had returned to be marginally above the ratio that Cicutto had inherited from Argus five years previously. Another Crikey.com insider ‘Barry Banker’ (Banker, 2004) claimed that second half reporting in November 2004 indicated a further cost blowout to a cost to income ratio of 54.1%. The cost-cutting ambitions of Positioning for Growth appear to have been poorly conceived and implemented. Apparently a key factor in the continuing high cost/income ratio were the English/Irish operations, but it was the Australian operations that were at the centre of the PFG strategy.

The NAB board also came in for some deserved attention. The *Financial Review*’s John Durie (Durie, 2004) noted:

NAB’s dismal operational performance shows its beleaguered board in its true light – its having failed to offer management any leadership and at the end it was revealed to be more interested in either personal advancement, survival or revenge.

The NAB, being an integral part of the Melbourne business establishment, has a board to match. They have been the beneficiaries of high annual fees (\$250,000 a year?) and are also the beneficiaries of retirement payouts (outgoing Chairman Mark Rayner took away a retirement package of \$1.47 million in 2001) that some commentators find unconscionable. The NAB has been criticised as having too many members who were probably appointed for their status (ex-CEOs), and too few with genuine banking and financial experience. The much-publicised and elongated conflict between the director Catherine Walter and the rest of the board between March and May 2004 was essentially trivial, with Walter’s position being hardly more defensible than that of the rest of the board.

## **The concept of corporate culture: NAB as case study**

As a consequence of the currency trading losses, the Australian Prudential Regulatory Authority launched an investigation into NAB. NAB commissioned its own report from PricewaterhouseCoopers.

The PwC report (the subject of much of the boardroom rancour between Catherine Walter and her fellow directors) was not a whitewash. Released on 12 March, it was described by Alan Kohler (2004) as as 'plain and thorough a horse-whipping of a big bank as anyone could want. ... The firm has pitilessly described a culture of arse-covering, snow jobs and deceit'.

The PwC report confirmed the corrupt character of trader activity and that there were no meaningful controls on the currency traders. Concerns raised in both internal and external audits (including from APRA) failed to be heard.

The APRA report was made public on 24 March (Australian Prudential and Regulation Authority, 2004). APRA offset years of anonymity and the obloquy of the HIH collapse with an assertive exercise of its formal responsibilities and powers. APRA withdrew, for the present, NAB's right to trade currency options, with other trading activities to be under observation. APRA also withdrew the bank's right to use its own internal model approach to measuring market risk, a right generally allowed to the top tier of banks. APRA also ordered the bank to engage in capital raising to accommodate stricter risk standards. APRA also dictated multiple changes in the detail of bank administration.

The APRA report is narrowly focused on the currency trading losses and the risk management failures that facilitated those losses. Of broader significance is that the report introduces 'culture' as an integral component of the NAB's failure. Typically the elusive concept of culture resides in a shady world of business school syllabuses infiltrated by less than kosher academic sociologists and the 'gee-whiz' language of bookshop potboilers offering the secrets of business success. But here is an official report discussing business culture in a sober fashion. The failure of the currency trading activities was not just a technical malfunction or attributable purely to a handful of rogue players, but reflected a systemic problem of administration in the bank. The report notes (2004: 72):

The culture that exists within NAB contributed to many of the control breakdowns that led to the currency options losses. While their effect is difficult to measure, we are in no doubt that cultural issues had a significant bearing on the extent of the losses that emerged – influencing both excessive risk-taking behaviour and the bank's capacity to detect it.

By the term 'culture', we refer not only to the working environment within the dealing room and the personal attitudes and behaviours of individuals associated with the currency options desk, but also to the wider environment within the bank and the attitudes displayed by key decision-makers to principles of risk management, transparency and candour.

APRA considers that the cultural issues thrown up by this investigation need to be treated with the same attention and seriousness as the technical and operational breakdowns.

APRA considered that the profit motive, or 'performance culture' had overwhelmed an appropriate culture that places risk management as a fundamental convention in appropriate banking practice. Ironically, the Bank has as part of its structure a People and Culture division, but the cultural label here appears to have been subsumed under measures to attune individual performance to corporate performance (profit). APRA does refer to specific dysfunctional dimensions of NAB culture ('highly regimented'; 'tendency to closely control information flows' – pp.73, 74) and to the 'wider environment', but the ramifications of a dysfunctional culture for NAB as a whole was not pursued. The implications of NAB's culture for small business borrowers is pursued below.

The *Financial Review's* Catherine Fox and Andrew Cornell (Fox & Cornell, 2004) delve atypically into this thing called 'culture':

It's a sign of the times that most corporate traumas these days are at least partly blamed on "culture". Culture was a culprit at Enron and One/Tel, and was mentioned often in analyses of the HIH collapse. And the word popped up frequently in the publicity surrounding the National Australia Bank's recent foreign exchange trading scandal.

But NAB has spent enormous amounts of money and time on culture change programs through the bank in the last two years, involving employees from all parts of the organisation and across most divisions. And these are only the latest attempts at making structural change in culture over the last decade. [They go on to note that the foreign exchange traders were reluctant attendees at culture classes.]

But what has this decade long transformation involved? The process involved attacking an 'old-fashioned hierarchy', a command and control bureaucratic management style, towards greater flexibility. With a workforce that had reached 42,500 (March 2004), and an evolving competitive environment, some change was necessary. However, the transformation involved the creation of a culture of profit-driven risk-taking with an incommensurate attention to risk management, precisely the conditions that produced the series of large scale problems described above. The backsliders are described as 'the men in the grey suits at the back, the committees who would say "you don't understand banking"'. Fox and Cornell, who view NAB's decade long attempts at cultural transformation with sympathy, don't see the irony. The proverbial baby has been thrown out with the bathwater. This point is the implicit nub of the APRA report. The culture that APRA finds unacceptable is a product of the cultural changes forged within NAB in the last fifteen years. The problem with NAB is not the heavy legacy of 'the men in grey suits' but the dearth of that legacy.

### **The Stewart era: new broom or more of the same?**

John Stewart, A Scotsman previously employed in the NAB's British subsidiaries, replaced Frank Cicutto in February 2004. The statements and initiative of the new CEO indicate the direction in which the Bank is being taken.

Stewart has overseen changes to purportedly overturn what has been exposed as a dysfunctional culture. The NAB's monthly employee magazine, *The Star*, disclosed in its August 2004 issue that the Bank receives about 4000 complaints a month. Many of these would be trivial in nature, although a breakdown provided highlights that 9% of the complaints are about lending products and practices. Data of this data never distinguish between retail and business customers. The public claim is that almost of all of these complaints are readily resolved, but the nature of those not readily resolved remains undisclosed, and the scale of the complaints processes in need of improvement.

The Bank's extant Customer Charter formally directs staff to 'Treat the customer with respect; Resolve issues efficiently; Be simple and transparent'. One recent vignette highlights that bank-customer differences can be more than a matter of simple misunderstanding, and that perhaps the Customer Charter has not been sufficiently implanted in staff culture. In June 2002, Kaye Cooper, a Victorian Western Districts grandmother, complained to her Colac branch for having been short-changed by the ATM. The acting manager denied that that was possible and subsequently called in the police who arrested Ms Cooper. She was subsequently found guilty in the local Magistrate's Court, fined and given a six-month good behaviour bond. Said Ms Cooper (Edmund, 2003):

I was treated like a con-artist. They thought I was trying to rip off the bank. ... It was the most degrading, humiliating experience of my life.

Ms Cooper, representing herself, had the charges overturned in April 2003. The NAB offered to pay her the amount of her Court fine which she described as 'vinegar being poured on an open wound'.

Following the condemnation of the NAB's internal culture by the regulatory authorities and within the media, the NAB devised a Statement of Corporate Principles. In August 2004, bank staff were issued with a statement of the new corporate principles. The Principles were reproduced in the Bank's September issue of *The Star*. Here are selective components:

We will be open and honest  
 We will tell it like it is (no spin)  
 We take time to explain issues and answer questions  
 We aim to ensure that there are no surprises. Mistakes and non-delivery are communicated early.

We take ownership and hold ourselves accountable (for all our actions)  
 We acknowledge our mistakes and if we get it wrong we will put it right  
 We all take responsibility for the way that customers experience the organisation

We treat everyone with fairness and respect  
 We build trusted relationships with all our stakeholders

We actively listen and respond appropriately to our stakeholders  
Decisions are made in a reasonable and consistent manner

A ‘culture-change program’ was to be implemented under the new head of ‘People and Culture’, Lynne Peacock, who Stewart had brought over in April 2004 from the UK. ‘You know how important I think it is that we get the culture right in NAB, because if we don’t get that right we are not going to get the financial performance’, said Stewart. The cultural-change program under Peacock’s direction was expected to take 18 months to two years to compete (Oldfield, 2004d).

But Peacock’s main concern appears to have been linking individual pay for performance (meaning contribution to profit). Peacock is reported as claiming that (Oldfield, 2004c):

... one of her priorities was to address a lack of differentiation between the remuneration of the top performers at the bank and those who were not delivering. ‘If people are not delivering, ultimately, this is not the place for them’, she said.

New Chairman Graham Kraehe also claimed that the new Corporate Principles were supposed to be used as criteria for assessing performance and pay.

This idea bears little relation to the current culture problems besetting NAB. One doesn’t create a functional and ethical organisation purely by financial incentive structures. Ms Peacock returned to the UK in October, leaving the implementation of the cultural-change program and the new incentive structure to others.<sup>3</sup>

Moreover, the Bank is formally planning introduction of ‘triple bottom line’ reporting (akin to Westpac formal practices) ‘as a means of improving relations with stakeholders’. This TBL drive is under the direction of Linda Funnell-Milner, under the elaborate title of ‘Group Manager, Corporate Social Responsibility’.<sup>4</sup>

The NAB also thinks that a change of physical surroundings and workplace design will facilitate the necessary cultural change. The sum of \$270 million has been committed to the new office space at Melbourne’s Docklands, and a new logo established, [National@Dockland](#), or N@D.

Some of the new developments appear to be even cruder responses to NAB’s loss of market share. CEO Stewart claimed in October that the bank would ‘adopt a more aggressive risk profile after the bank had shed billions of dollars in higher-risk business loans in preparation for what bank strategists thought would be an economic slowdown after the 9/11 terrorist attacks’ (Oldfield, 2004e). Media commentators noted that easier NAB lending policies ‘were playing a role in a dramatic market move in Sydney real

<sup>3</sup> Ms Peacock is now CEO of NAB’s European business, and her remuneration has been boosted to £525,000 (\$1.3 million), with the possibility of a doubling of that figure if short-term performance hurdles are met. The promotion of Ms Peacock has been meteoric, but there is no evidence that her presence in Australia for six months produced positive change of any significance.

<sup>4</sup> It is reported that Ms Funnell-Milner comes from Westpac, having worked on similar concerns under Noel Purcell. This is presumably the same Noel Purcell who headed the team that dissembled wildly in front of the Martin banking inquiry in 1991 over Westpac’s disgraceful involvement in foreign currency loans. Presumably Mr Purcell has learnt something about corporate social responsibility in the intervening period.

estate' (Gottliebsen, 2004). Stewart had earlier planned to tackle declining earnings in its UK operations (which had been organised for close attention in March but had to be sidelined because of the chaos in Australia) by shaving interest margins, a 'strategy' that Deutsche Bank predicted could only lower earnings further.

Another late 2004 move was the amalgamation of the separate retail, corporate business and wealth management divisions into a combined structure. The ambition was to 'cut the corporate fat', with particular initial attention to rationalising the combined corporate affairs departments. When one wishes to denigrate separate structures, the label 'silo' is conjured up, with implications of divergent cultures and costly lack of integration (Oldfield, 2004d). But amalgamation of business segments with different modes of operation will also have its problems. This most recent reorganisation has all the hallmarks of a poorly thought-out 'change for change's sake'. A key motivation for Stewart for the amalgamation appears to be as a vehicle for the cross-selling of products, yet the quality of the products or the appropriateness of the customer base for cross-selling doesn't seem to have entered into the equation.

November saw a plan for driving higher sales of insurance and investment products to customers by giving incentive payments to branch staff to refer customers to NAB's financial planning arm (Boyd, 2004c).

The most surprising of the strategic initiatives under Stewart has been the attention to public relations.

### **Public relations as a priority initiative**

In May 2004, NAB hired Marketing and Research Associates to interview selective 'opinion makers, clients and investors to gauge their response to the recent turmoil in the bank. The findings were to be used to create a 'stakeholder relationship index'. The index is supposed to capture the 'four distinct dimensions of relationships' – trust, commitment, satisfaction and mutuality of control. CEO Stewart is quoted as claiming: 'National's strategy includes building trusted relationships with stakeholders. Therefore, the strength and quality of our stakeholder relationships are of critical importance to us' (Hughes, 2004).

In September came the centerpiece of the new push into public relations. According to a September media report, 'National Australia Bank is counting on a sponsorship of the 2006 Melbourne Commonwealth Games to help repair its battered reputation and give it a more human image'. NAB sent a promotional pack to its 20,000 staff, asking for shoe sizes, planning to send every employee a pair of Adidas running shoes. These were to help staff participate in a 'journey' back to a healthier reputation. NAB marketing manager Chris Bulford is reported as claiming that 'the NAB brand is regarded as trustworthy and the most premium of the big four bank brands, but it can be seen as a bit aloof'. Claimed Bulford, 'One of the aims of our sponsorship is to make people proud to be associated with NAB' (Shoebriidge, 2004a).

Contemporaneously, NAB hired the market research firm Crosby Textor Research Strategies Results to do in-depth interviews with government ministers, regulators and journalists. There was no indication of how this new initiative was related to the May

initiative. Given the spinelessness to passivity of personnel in all three categories, one can't expect too much feedback of a bracing nature.

In October, NAB unveiled its 'brand fight-back strategy' of advertising under the rubric 'Our journey begins'. The advertisements were mooted to cost between \$15 million and \$20 million. Chris Bulford noted that research indicated that consumers 'wanted us to be honest and straightforward. ... Some will be cynical about this [advertising] campaign and our statement that we want to change'. The television advertisement showed a swimmer training for the Commonwealth Games (Shoebridge, 2004b).

The APRA report, in its Chapter 6 on Culture, noted disapprovingly if soberly: 'Managing the message was frequently given equal, or greater, priority than dealing with the underlying issue' (2004: 74). Presumably, all this expenditure on brand image is oriented to more admirable purposes than the practices which gave rise to the APRA report and its criticisms.

### **The NAB and small business borrowers**

The comprehensive media attention that has covered NAB activities as outlined above has generally been silent on the small and medium enterprise (SME) lending segment. The NAB and the Commonwealth Bank of Australia are the two largest lenders to the SME market. NAB's market share of SME lending dropped marginally in 2004. The NAB credits this drop with it being overly concerned with credit quality and has implemented an 'overly-rigorous credit assessment'. This is a peculiar interpretation of NAB-small business relations.

A rare treatment of the small business dimension was reportage to the effect that NAB is looking to recover its SME market share by lending to no-staff sole proprietors, a so-called 'lower-quality asset class'. The NAB is looking at loans secured against the home (reported as if this was an atypical practice); yet it claims that this prospect will be driven not by its own preferences but those of the prospective customer, which class is said to like the idea of home equity loan (Cornell, 2004c). Indeed, advertisements appeared in the press in December 2003 offering a Business Mortgage Combination Loan secured on residential property, on a discounted interest rate for the first six months (*Australian Financial Review*, 2 December 2003).

Cases have persistently arisen of conflict between the NAB and particular small business borrowers. Material surrounding these conflicts is patchy, especially if the conflicts do not go through the courts; even then, significant documentation is lacking for lack of adequate discovery by the Bank. What evidence exists does point *prima facie*, in some instances, to unconscionable conduct on the part of NAB and, in some cases, fraud. A sample of cases (ranging over the previous 20 years) is summarised in Evan Jones (2004). Such conflicts are rarely reported in the press (with the exception of occasional coverage by *Sydney Morning Herald* journalist Anne Lampe). Material from the Jones Working Paper was drawn on in several newspaper articles (Oldfield, 2004b; McCarthy, 2004). Rare official coverage of such conflicts appeared in the 1997 federal Parliamentary Report, *Finding a Balance* (House of Representatives Standing Committee on Industry, Science and Technology, 1997).

Some changes in the regulatory structure occurred following the tabling of *Finding a Balance*. In particular, the Australian Competition and Consumer Commission was allocated a Commissioner specifically for 'small business'. Most relevant in this context, the Trade Practices Act was amended by the inclusion of a new Section 51AC. This Section specifically provides for redress by small business against unconscionable conduct by larger businesses. In practice, the Section has proved to be dead letter, partly in terms of the wording hurdle needed to prove 'unconscionability', but fundamentally for lack of initiative on the part of the ACCC that oversees the Act. The regulatory position was further muddled and weakened when the Australian Securities and Investments Commission was handed responsibility in 2001 (following the Howard Government's re-election), effective March 2002, for unconscionability sections of the Trade Practices Act that involved financial dealings. ASIC has declined to accept accountability for a role for which it has formal responsibility.

In an environment of regulatory lassitude, corporate self-directed attitudes and behaviour become paramount. In this context, NAB's September Statement of Corporate Principles becomes highly significant.

Some of the small business proprietors (more accurately, ex-proprietors) cited in the Working Paper have attempted communication with NAB in an effort to have their cases reviewed and treated more judiciously. What has been the response of NAB?

#### Paul Buckman and Basstech

Basstech was a Gippsland based company servicing the refining and manufacturing sectors with electronic repair, calibration and testing authorities / certification services. In May 1999, the Proprietors discovered that their accountant had been forging cheques systematically for seven months. A substantial percentage of these cheques had been observed by NAB bank staff as possessing a signature 'not on system', yet the staff continued to process them, sometimes paid out as Cash. The Accountant was subsequently found guilty and jailed, but NAB declined to accept responsibility. Instead, it forced the Basstech into bankruptcy.

Paul Buckman, one of the two Basstech partners, has correspondence from NAB.

i. James Litt, Head of Customer Resolutions, wrote on 23 January 2004 (on behalf of the Managing Director):

I note that in a letter from [the Insolvency and Trustee Service Australia] dated 30/6/2000, they indicate that contained within your Statement of Affairs was an expectation of compensation from the Bank in relation to "fraudulent acts committed in respect of the Basstech companies of which [you were] formerly a director". ... The Bank's file of Basstech Pty Ltd has been closed and accordingly no further correspondence will be forthcoming.

ii. Mal Walker, Executive, Credit Restructuring Victoria & Tas, wrote on 2 April 2003:

we advise that we are still looking into your complaint against the National.

Buckman wrote to John Stewart on 20 September 2004. It was an eight page letter accompanied by attachments, giving the background in detail to the Basstech experience. Buckman welcomed Stewart to his new role as CEO thus:

I have in recent times (the past 5 years) sought redress from the National Australia Bank to no avail. In spite of this & as a matter of courtesy to you, I am offering you the opportunity to resolve these outstanding issues. That assumes that you are a man of ethics & integrity, as opposed to a mere banker. Given the conduct of your bank in these matters to date, one could reasonably be excused for believing that an “ethical banker of integrity” is an oxymoron. This document & attachments are delivered without prejudice.

iii. Kathleen Russell, Head of Customer Resolutions (Relieving), replied on 25 October 2004:

I refer to your letter dated 20 September 2004 addressed to John Stewart. ... In response, I refer you to our letter of 23 January 2003 signed by James Litt.

#### The Goonans and Saretto

Tony and Lorise Goonan ran two hardware stores out of Singleton and Forster, New South Wales. In late 2000, the stores (especially Forster) were hit with declining sales, due to unpredictable and probably non-recurring factors. Tony Goonan sought an overdraft extension in April, but there were mixed signals and delays at his Singleton branch, with Goonan belatedly being requested to write a letter in August setting out details. The Goonans had one major supplier creditor, and the hope was that the overdraft extension would reduce indebtedness to that creditor to normal terms, and trade out of difficulty.

After months of delay, Tony Goonan received a phone call from Deloitte on 22 October that the NAB had foreclosed on the facilities. The spokesperson from Deloitte gave him two months grace to sell his business and homes. The Goonans placed their company in voluntary administration, with a view to trading through their immediate difficulties (with administrator agreement at a 29 November meeting), especially taking advantage of the typically more buoyant Christmas period, or to sell the businesses on decent terms in the new year. Yet the administrator (with major creditor NAB) reneged on the plan and placed the company into liquidation a week before Christmas. On Christmas Eve, the Forster stock was trucked to Singleton with a view to a fire sale early in the new year. The Goonans were forced to place themselves in bankruptcy in February 2002.

The Goonans were not in default, with a sound payment history. No written advice was received from Deloitte. No written or verbal advice was received from the NAB advising foreclosure in spite of requirement to that effect in the loan documents. The NAB ‘Business Secured Overdraft’ document has, in section 5 (Operating the facility):

Despite 6 below [regarding review of the customer’s operation of the facility], the *Bank* may cancel the facility at any time whether or not *you* are in breach of this agreement. Where the facility is cancelled:

(a) the *Bank* will give you notice of the cancellation as soon as practical

What of NAB correspondence?

- i. Sonya Piredda, of State Asset Structuring, wrote on 24 January 2002:

As you are aware, the company is in default by virtue of the appointment of an Administrator (Liquidator) to it.

No such arrangement exists in the loan documentation. The presumption of synonymy of administrator and liquidator is curious. The Business Secured Overdraft document noted [section 14. Defaults]:

If *you* are in default and:

- (a) the *Bank* has given you or any guarantor, a default notice; and
- (b) the default has not been remedied;

Then, unless the *Bank* notifies *you* to the contrary:  
the *Bank* may bring enforcement proceedings against *you*.

Section 14 (a) was honoured in the breach by the Bank.

There was an earlier discussion about the prospects of other members of the Goonan family purchasing one of the secured parental properties. At the December meeting, at which NAB decided to liquidate the company, a NAB representative recommended that the Goonans sell the two homes themselves. The 24 January letter advises of the procedure that the Goonans should follow to satisfy 'What the Bank requires for the proposed sale of the Old Bar property', involving a qualified valuation, etc. The Goonans proceeded to follow this advice and obtained qualified valuations and legal advice in early February at a total cost of \$1800.

- ii. Geoff Rose, Senior Manager, Credit Restructuring, wrote on 13 May 2002:

Following the receipt of the bank's internal assessment of market value I contacted the solicitor acting for the proposed purchaser on 19 April 2002 [a delay of two months] and advised the offer was not acceptable to the bank.

The Goonans had written to Rose on 8 May, following earlier verbal advice that the bank had rejected the valuation and the offer based on it. The Goonan letter stated:

What I would like to know Mr Rose, is how you can come up with a "substantially" higher valuation when there has not been another valuer on or in this property apart from the two previously mentioned.

The Rose 13 May letter responded:

Please note that the allegations made in this correspondence are refuted in their entirety.

The Bank established a procedure that involved the incurring of expense by the Goonans, then declined to follow its own procedures and in the process disassembling an alternative valuation of the Old Bar property.

iii. Manager [no name, signature indecipherable, no division on letterhead] wrote on 15 August 2002, 'pursuant to section 57(2)(b) of the Real Property Act, 1900', issuing demand for the sum of \$781,985.89. The letter claims default under an executed Guarantee and Indemnity

by failing to pay in accordance with the demand dated 29 July 2002 made by the Bank.

No demand letter was received by either of the Goonans; one can safely infer that no demand letter was sent. Moreover, the sum claimed owing by the Bank in August is inflated by the fact that the Bank had closed down the business before the busy holiday period, and that both of the Goonan properties remained, at the discretion of the Bank, unsold.

On 21 March 2004, Tony Goonan wrote a letter of complaint to the Bank, via his local federal Member, Mark Vaile, to be given to NAB Chairman Graeme Kraeche, with whom Vaile was acquainted.

iv. Michael O'Sullivan, Head of Business Financial Services, Provincial NSW, replied on 6 May. O'Sullivan claimed that demands were issued on the company on 2 July 2002 and sent to the registered office; demands were issued on the Goonans as guarantors on 29 July and sent to their two residences. The Goonans noted that the company's registered office was that of their accountant, who received no notices, that the banks were in possession of the residences, and that their Trustee in Bankruptcy and the Post Office had their forward address.

To the Goonan's claim that loan documentation requires notification of cancellation of facilities in writing, O'Sullivan denies this, citing Section 5 (as noted above, 'the Bank will give you notice of the cancellation as soon as practical'). Although O'Sullivan's is a literally correct reading of the section, to deny the necessity for notification in writing of such a momentous occasion in a bank-customer relation invites ridicule. O'Sullivan goes on to claim that 'it is the Bank's normal practice to provide notice in writing and I advise that we hold draft copies of cancellation notices for the Business Mortgage Overdraft Facilities'. That the Bank holds only draft copies and not copies of documents purportedly sent is curious. That O'Sullivan declines to forward these draft copies to the Goonans is additionally curious. One is led to infer that no cancellation notices dated 2 July were sent to the Goonan accountant's office as they were never prepared.

Regarding the Goonan's accusations of the Bank's illegality in foreclosing on the Goonans, O'Sullivan notes (correctly) that the Overdraft facility documentation allows the Bank 'to cancel the facilities at any time'. Indeed he repeats the point later in the letter. But as if to tacitly accept the moral illegitimacy of acting on this provision, O'Sullivan then lists more tangible reasons for foreclosure – claiming that the Goonans defaulted serially when placing the company into voluntary administration on 22 November 2001, when the liquidator was appointed on 19 December and when the Goonans placed themselves into bankruptcy on 19 February 2002. O'Sullivan also claims that the decision to liquidate the company was out of the Bank's hands as the company proposed no Deed of Company Arrangement.

O'Sullivan also claims authority and autonomy of the Bank over property valuations and sale, and business valuation and disposal of assets. Finally, O'Sullivan summarises the total owing to the Bank as at 4 October 2001 as \$942,062.

Tony Goonan replied to O'Sullivan on 7 June. Regarding responsibility for default, Goonan claimed that the Bank had cancelled its facilities on 22 October 2001. Goonan had previously claimed in his 21 March letter that Gavin Baigell of Deloitte had called Tony Goonan on 22 October to say that 'the National Australia Bank had cancelled all my Company loan facilities, that I had two months to sell my real estate and to get re-financed'. O'Sullivan declined to mention the appointment of Deloitte or their role in his 6 May letter.

Goonan reiterated that the Bank's sale of their properties was under value, because both properties had been left to deteriorate after months of lying vacant, and that no property can achieve its market value if tagged with a 'mortgagee in possession' label. Goonan also claimed that their estimate of debt was \$829,000, which is \$113,000 less than the figure claimed by O'Sullivan.

Finally, Goonan noted 'My company complied with all your terms and conditions and complied with all special provisions of the facilities but I obviously didn't pass your stress test (whatever that is!!!!) nor your profit requirements'.

v. O'Sullivan replied to Tony Goonan on 1 July. He attached copies of demands claimed to be issued on 4 July and 29 July 2002. Tony Goonan having raised the Deloitte involvement, O'Sullivan claims that:

due to subsisting defaults on the facilities it was the National's intention to exit its relationship with the company. At that stage none of the company's facilities were cancelled.

O'Sullivan details evidence of continued payments to show that the facilities had not been cancelled at that stage. O'Sullivan claims that Goonan had written to the Bank on 2 August 2001 admitting inability to pay a creditor a sum of \$96,000, and conceding that the businesses were not viable. That inability to pay debts:

constituted a default under the terms and conditions of the overdraft facilities.

So now we have a new basis for foreclosure, operative some time between August and October 2001, but one not outlined in O'Sullivan's letter of 6 May and which is relayed to Goonan for the first time almost three years later.

O'Sullivan concedes that the earlier claim of debt was inaccurate, and that the debt owed was instead \$835,061.00. This figure is a mere \$107,001 less than the original claimed debt. What was the basis for the original claim? O'Sullivan merely says:

The National apologies for the error in our earlier letter.

O'Sullivan also claims that:

It was also the opinion of the administrator that the company was insolvent and in his second report to creditors dated 11 December 2001 he recommended that the company be placed into liquidation.

This is a curious affair because Goonan notes, in his 21 March letter, that ‘On the 29 November 2001, a creditors meeting was held at Knights office in Sydney. It was agreed the business would continue trading and that Knights would restock the stores’. Yet 13 days later, the administrator is telling a contrary story. This contretemps doesn’t have the stamp of professional integrity on it.

O’Sullivan concludes with a personal touch but outlining the imperatives of the market:

I appreciate that the events following the failure of your businesses and the subsequent impact on you and your family has been very distressing. The financial situation of the company at the time was such that the National, who (sic) also acts in the best interest of its shareholders, was not in a position to advance further funds to the company and could not continue to support an entity, which was clearly insolvent.

Whilst contact and communication with you became increasingly difficult and hostile and perhaps understandably so, we have at all times endeavoured to act in a professional and considerate manner.

Unlike the typical correspondence between NAB and aggrieved customers, the Goonan/NAB correspondence was crossing the desk of a federal Minister. This enunciation of NAB professionalism would appear to have been penned with one eye on the public relations implications of exposure to a person of potential influence.

### The McMinns

Alan and Wilma McMinn switched their banking to NAB in 1995 following a productive exchange with a NAB branch business manager. They purchased a child care centre in southern Queensland and, with help from the NAB manager, developed a plan for expansion. The McMinns then experienced a series of different managers in quick succession but, in August 1996, another new manager endorsed the original business plan and supported the expansion via the construction of a new adjacent and complementary centre catering for babies. In the middle of construction in December 1996 the Bank ordered construction halted, without explanation. Construction did not re-commence until March 1997, by which time the opportunity for new year enrolments had passed and currently enrolled families moved elsewhere.

The Bank declined to restructure loan commitments, instead imposing a penalty interest rate on debt repayments. The McMinns went into default and were bankrupted by NAB. Their childcare centre was sold for significantly under value, in spite of the existence of a contracted higher offer.

What of NAB correspondence? Alan McMinn addressed a letter of complaint on 17 May 2004 to the new NAB John Stewart and his new manager, People and Culture, Ms Lynne Peacock. Peacock, who was at that stage working on cultural renewal, remained detached from the minor matters of aggrieved customers.

- i. James Litt, Head of Customer Resolutions, replied for Stewart and Peacock on 25 June:

As you are aware, in July 2002 the Supreme Court in Brisbane upheld that the Bank was entitled to judgement against you both to an amount of \$290,000, with the Court also giving you leave to defend the Bank's claim. Your defence and counter claim were subsequently lodged in the Supreme Court and to date have not been progressed.

This matter is being managed for the Bank by Thynne & Macartney Solicitors, who can be contacted on ... .

NAB had the McMinns bankrupted, with a claim of \$843,000. The McMinns went to court with a counterclaim, and the judge reduced the sum to \$290,000, granting the prospect of a further counterclaim. Further court action remains pending, given lack of funds available to the McMinns.

NAB sold the childcare centre for \$1,180,000 in the face of a contract for \$1,700,000, later reduced to \$1,510,000 when the offerers became aware of receivership. There was also a 1996 valuation by a respected Queensland valuer for a post-completion value of over \$2 million. Given these figures, a claimed deficit of \$290,000 can be put into perspective.

Further letters of 6 August from McMinn were addressed to Stewart and Peacock.

- ii. James Litt replied on 13 August:

As previously advised this matter is being arranged for the Bank by Thynne & Macartney Solicitors, to whom I have forwarded your correspondence.

### The Walter family

The Walter family was induced to migrate from Germany as business migrants following strong promotion at the Frankfurt office of the Victorian government. The Victorian government was promoting its State as offering, amongst other fundamental conditions, 'a cost efficient place to do business' and 'secure and familiar legal and financial infrastructure and services'. Several million dollars were transferred from Germany and committed to the construction of a boutique brewery and restaurant in Wodonga, which opened in mid 1998. Interim financial accommodation was obtained from the Wodonga branch of the NAB.

Within five months it was clear that business turnover was not up to expectations. The Walters sought a restructuring of their facilities. Belatedly in December they were handed without explanation and on a take-it-or-leave-it basis a restructured package centred on a fixed interest one-year loan of \$1m. The Walters' initial bank manager had been replaced, and a succession of managers followed in 1999. A request for clarification of bank fees in May was met with a belated demand for a reduction of debt of \$100,000 through asset sales.

Out of the blue in February 2000, interest rates were raised to penalty levels. The Walters were never told that their accounts had been downgraded to impaired status and moved to the Asset Structuring Unit in October 1999. In mid April, the Walters were instructed to sell their business and home within six weeks. The Walters were not in default on their payments. A meeting with Ben Eadey, Head of Asset Structuring, in Melbourne in September was met with the response 'we don't want you'. A subsequent meeting with Ray Pridmore, global Head of Asset Structuring, was met with refusal of assistance as it was claimed that the Walters' assets had been eroded. The Bank appointed a receiver in December, with the subsequent sale of the business property in March and appropriation of the home in August 2004.

In her (losing) suits against the receiver and the Bank in the courts, Carmen Walter persistently failed to get adequate discovery of documents from the Bank.

#### Implications of the cases of Buckman, Goonan, McMinn and Walter

The vignettes of four small businesses that were foreclosed by NAB highlight a range of practices by NAB that do not sit well with its new Statement of Corporate Principles. NAB has exhibited poor service, with unstable turnover of key branch personnel and inappropriate lending products; NAB's approach to information disclosure has been woeful, with failure to notify customers when the Bank has altered a customer's status, contradictory advice and misrepresentation, the continued use of discretionary secret Red Ink accounts for impaired customers, and the inadequate discovery of documents when in dispute; the severe treatment of customers in receivership; and so on.

There is no acknowledgment of any activity as a 'mistake'. In terms of the key planks of the Corporate Principles, openness and honesty, responsibility and accountability, and fairness and respect, are all thin on the ground or contravened. Much of the practices described in these case accounts took place before August 2004, but the banking sector has faced an evolving code of banking practice since 1993, after the sector was subject to a withering barrage of complaints that led to Labor's Martin banking inquiry in 1990. Moreover, the people involved in all four cases outlined are still seeking redress, as reflected in the selective discussion of continuing correspondence. Corporate principles, it appears, do not apply to small business lending.

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