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Committee Secretary
Senate Standing Committee on Economics
Department of the Senate, Parliament House, CANBERRA ACT 2600
By email: [REDACTED]

Dear Sir/Madam

Inquiry into Australian Business Growth Fund Bill 2019 (“BGF bill”) – Treasury Submission Competitive Neutrality

We refer to Treasury’s submission to the Senate Committee (undated) and made publicly available on the Senate Committee’s website yesterday afternoon regarding the application of Competitive Neutrality principles to the Australian Business Growth Fund (**ABGF**).

We note that Treasury has acknowledged that the Government’s Competitive Neutrality principle applies to the ABGF *“because of the Commonwealth’s shareholder in the Fund and commercial nature of its activities.”*

However, it is disingenuous for the Treasury official to claim that *“the ABGF has been designed to minimise potential detrimental effects on competition in a manner consistent with achieving competitive neutrality as much as possible”*.

Only last week the same Treasury official testified to the Senate Committee that the ABGF could not ‘crowd out the market’ because: *“the message that we got clearly from those was that there was a funding gap” ... “There was a funding gap in terms of equity financing”*

It is impossible and contradictory to simultaneously attempt to maintain a position that the ABGF bill was prepared because there was a *“market gap”*, while arguing at the same time that it *“has been designed to minimise potential detrimental effects on competition”*. The Treasury official has been arguing that the ABGF is required for the reason that there is no competition.

Frankly, it is beneath Treasury to then attempt to rationalise its position that the ABGF does not benefit from the proposal to allow its bank shareholders to commit up to 2% of CET1 capital into the fund and receive concessionary prudential treatment, allowing the ABGF to access >\$5 billion of concessionary capital.

As Treasury well knows, the state of prudential regulation prior to the concession being granted in respect of the ABGF is that the banks must set aside \$1 of equity for every \$1 equity contributed to the ABGF. The prudential change (as agreed by APRA in its testimony to the Senate Committee) enables the bank shareholders to ‘equity-account’ for only ~\$0.25c of each dollar of equity invested. This enables the bank shareholders to effectively ‘debt-fund’ the balance (~75%) of their investment in the ABGF. We know of no other Australian private sector investor that can access (cheap) debt funding to make high-risk SME equity investments.

The result is that the ABGF's weighted average cost of capital is extremely low compared to other market participants. With Government providing 19% of equity (financed at extremely low rates) and the banks providing 81% of equity (with ~75% of that from the debt markets), we estimate the ABGF's WACC to be lower than 5% (however, given the minimal time frame provided to revert to the Committee, we will need further time to estimate the current WACC accurately). This compares with the ~30% returns required by the private sector to invest in risky SMEs. This gives the ABGF an unassailable advantage over the private sector (which according to Treasury's 'market gap' arguments, doesn't exist).

As APRA has noted in its Letters: Capital treatment of investments in the Australian Business Growth Fund dated Monday 9 December 2019, this APRA treatment only occurs because:

"The inclusion of the Australian Government as a founding shareholder in the ABGF supports APRA providing a special treatment, subject to prudential safeguards, for this investment compared to other equity investments."

The proposition that the ABGF does not benefit from the prudential treatment begs the question of why APRA is providing the concession and directly referencing the ABGF as the reason for the change.

It is facile to suggest that the ABGF does not receive a financial benefit as a result of regulatory invention by the Government with respect to the APRA concessions on its shareholders and the Government funding, and as a result that this does not breach the Government's Competitive Neutrality Policy 1996.

Treasury concludes by notes that there are a number of submissions to the committee that support the ABGF. I am unsure of how this relates to Competitive Neutrality, but also note that 3 submissions are from banks (who will benefit as shareholders), one submission is from their lobby group (the Aust. Bankers Association), one from a Government entity, and one from a company that mistakenly believed it would be eligible for the ABGF, but fails the minimum revenue test and the profits test.

I note that the RBA has lodged a letter with the Senate Committee that does not contain a recommendation for the ABGF.

Two other independent submissions have lodged objections, and raised numerous valid issues, such as *"Proposed Bill Is Targeting the Wrong SME Segments"*

And, I note that the Australian Shareholders Association has lodged a submission objecting to the ABGF and supporting our proposed amendment to the bill to ensure that all Australians have an equal opportunity to invest in SMEs underwritten by the BGF.

Yours sincerely



Ben Bucknell
CEO and co-founder
OnMarket BookBuilds