

Coalition Senators' Dissenting Report

1.1 ABIP, or "Rudd bank" as it is more commonly known, is touted by the Government as a contingency measure proposed to cover the possible need for refinancing of viable commercial property projects if the foreign banks withdraw from the commercial property market. However there was no evidence tendered to the Committee of the intention of any foreign banks to withdraw from the commercial property market and the question must be asked as to whether this proposal is not an unnecessary overreaction to an unlikely possibility.

1.2 Furthermore Professor Henry Ergas of Concept economics made out a very cogent case that the establishment of "Ruddbank" would actually encourage the foreign banks to withdraw from the commercial property market and in fact create the very problem that ABIP has been proposed to deal with.

1.3 Coalition Senators have grave concerns in regard to the potential for conflicts of interest, potential abuse of market power and biased decision making to occur through ABIP as it stands. This is due to the combined effects of the exemption of the Rudd bank from the Trade Practices Act, and the composition of the ABIP Board which consists not of independent directors but of representatives of the four major banks, each of whom has the right to veto any proposal.

1.4 Unusually for an Agency established by Government there are no clear lines of accountability for ABIP either to a Minister or to the Parliament. Instead it seems that the Government's intention is for the company to provide refinancing loans up to the value of \$28 billion without any formal accountability process in place.

1.5 Evidence was given that the ACCC was not involved in discussions of any significant manner with Treasury about the implications of the exemption from the TPA or the legal framework within which ABIP Rudd Bank would operate. Coalition Senators found this very surprising given the role of the ACCC as the competition watchdog of Australian business.

Discussion of issues of concern

Rationale for establishment of Rudd Bank

1.6 When the ABIP or Rudd Bank was first announced the Prime Minister said the purpose was to support jobs in the commercial property sector should foreign banks withdraw from the commercial property market leaving projects in need of refinancing.

1.7 In evidence given to the Committee, the Property Council of Australia said that of the 23 foreign banks in Australia only one, the Royal Bank of Scotland, had withdrawn from the Australian market and added that the US Citigroup faced difficulties. However it has to be borne in mind that both of these banks faced unique solvency problems in their respective home countries and that the Royal Bank of Scotland sold Bankwest to help improve their position in Scotland and that the Citigroup was enmeshed in the banking crisis in the USA but remains in Australia.

1.8 The Reserve Bank's February 2009 statement on monetary policy states;

Over recent months there has been some speculation that many foreign-owned banks will withdraw from the Australian market and that this will create a significant funding shortfall for business. While there is a risk that some foreign lenders will scale back their Australian operation, particularly if offshore financial markets deteriorate further, at this stage there is little sign of this, with most of the large foreign-owned banks planning to maintain their lending activities in the Australian market.

1.9 No specific evidence was provided to the committee of further foreign banks planning to withdraw from Australia altogether or from the Australian commercial property market but instead vague references were made to what appeared to be unsubstantiated possibilities that some foreign banks might be considering withdrawing from the Australia commercial property market.

1.10 While the Government's stated purpose in establishing Rudd bank is to mitigate the impact on employment of any withdrawal from the Australian market the respected Economist Professor Henry Ergas in his submission from Concept Economics disagreed strongly with the Government writing ;

“[t]here seems to be little convincing evidence justifying the primary rationale for the proposal – bailing out distressed syndicated commercial property lenders and preventing fire sales – and even less evidence of a market failure in respect of the secondary purpose of financing commercial lending in general.”¹

1.11 He then goes on to suggest that:

“This points to one of the major problems with the proposal: the moral hazard that it creates. There is a material risk that the initiative could actually encourage the very actions it is designed the very actions it is designed to forestall. Forced with a one-way bet, developers have an incentive to play off their existing foreign lenders which, in turn, could accelerate their withdrawal from the Australia market.”²

¹ Concept Economics, *Submission 10*, p11.

² Concept Economics, *Submission 10*, p12.

1.12 Coalition Senators agree with Professor Ergas that there appears to be no evidence to support the basic rationale for the establishment of the Rudd Bank, namely that there will be an exodus of foreign banks from Australia.

1.13 Furthermore Coalition Senators find themselves persuaded by the logic of the argument Professor Ergas makes that, if enacted, the ABIP/ Rudd bank proposal could actually facilitate the withdrawal of the foreign banks from the Australian commercial property market which is the very problem that ABIP is proposed to forestall.

Conflict of Interest and Moral Hazard

1.14 The gravest concern Coalition Senators have about ABIP is that the proposed Board structure consisting of representatives of the five shareholders in the Company namely the Government and the four major Australian Banks lends itself to the possibility of conflict of interest and abuse of market power. This is because all four of the banks are involved in financing commercial property developments and each has a veto over any decisions of the Board of ABIP.

1.15 The validity of these concerns was highlighted by evidence given by Professor Ergas who said:

“The majority of commercial property exposures in Australia are held by domestic banks. In particular, most exposures are held by the proposed shareholders of the new entity – the four major banks.”³

1.16 Professor Ergas quantified these holdings in monetary terms stating that;

”Australia’s major banks hold \$103.8 billion or 63.1 per cent of commercial property exposures, with \$30.5 billion (18.5 per cent) held by other domestic banks.”⁴

1.17 ABIP will be established under the Corporations Act and is a public company with limited shares. The shareholders will be the Commonwealth Government and Australia’s 4 major banks, who will each have a delegate to the Board. Board decisions are required to be unanimous and the Chair will be appointed by the Treasury.

1.18 Coalition Senators are concerned that with the major 4 Australian banks holding such a large proportion of commercial property exposure, there will inevitably be conflicts of interest for the four major banks in their role as members of the Board of ABIP.

³ Concept Economics, *Submission 10*, p 7.

⁴ Concept Economics, *Submission 10*, p 7.

1.19 The chief objectives of ABIP is said to be to protect syndicated commercial property loans should foreign banks leave Australia and again the 4 banks who are on the Board of ABIP are major players in syndicated property financing as stated by the RBA;

“...the syndicated loan market in Australia. In nearly all of the deals completed in 2004/05, at least one of the major banks was involved in arranging the loans, and together they committed around half of the funding for these deals.”⁵

1.20 Professor Ergas expressed great concern about the potential for conflict of interest composing the Board in this manner will provide:

“The evidence also suggests that the shareholders of the new entity – the major banks – are the primary domestic players in the syndicated lending market and could face considerable conflicts of interest in their decisions to refinance using the entity’s facilities. After all, the individual shareholders stand to be the major beneficiaries of their own decisions to use taxpayer funds to refinance loans and support commercial property prices. Since the banks’ balance sheets must reflect market prices, ABIP’s shareholders – the major banks – would be very reluctant to accept any taxpayer refinancing of loans if that support constitutes less than 100 cents in the dollar. This becomes problematic if the true market value of that asset is far less than 100 cents in the dollar – taxpayers will effectively end up paying too much too much to refinance these loans.”⁶

1.21 It would seem that given the high level of investment of the 4 major banks in the commercial property and syndicated financing markets, the scope for conflict of interest is undeniably high.

1.22 Coalition Senators believe this is unacceptable and not in the public interest.

Job saving

1.23 The Prime Minister states that APIB will prevent the loss of 50,000 jobs, however, Coalition Senators find this proposition does not stand up to scrutiny and amounts to no more than Rudd rhetoric.

1.24 As Mr Verwer, CEO of the The Property Council, stated during the hearings in Sydney:

“ABIP does not put new money into the system and therefore is not a source of funds for new investment.”⁷

⁵ “Syndicated Lending”, RBA Bulletin, September 2005.

⁶ Concept Economics, *Submission 10*, p12.

⁷ Mr Peter Verwer, *Proof Committee Hansard*, 14 April 2009, p 9.

1.25 In effect this means that ABIP will not be engaging in starting new projects which would create employment. Nor under the terms of its operation will ABIP invest in projects which are not commercially viable. Accordingly, if ABIP will not be providing funding for new construction and instead only investing in successfully operating companies, accordingly it is reasonable to draw the conclusion that the only commercial property projects in which job losses might occur would be projects which were not commercially viable in the first place and which will not be eligible for assistance in re-financing from ABIP.

1.26 Accordingly, Coalition Senators are of the opinion that the Prime Minister's claims about job preservation and protection lack credibility.

Scope of ABIP

1.27 Several submissions, including Professor Ergas's, questioned the rationale behind limiting ABIP's re-financing assistance to the commercial property market and no other sectors of the economy.

1.28 Why, for example, has no mention been made of the needs of small business or the agrarian or mining sectors, the latter of which is heavily dependent on foreign investment?

1.29 Senator Eggleston queried Mr Peter Verwer of the Property Council on this issue:

Senator EGGLESTON – “I just asked you what your special case was. The other sector which does of course have a lot of foreign investment is mining. Are you saying that the property sector has a higher percentage of investment than the mining sector?”

1.30 The provision of the Commonwealth creating a safety net solely for the commercial property market despite the fact that other sectors of the economy were arguably subject to the possibility of similar difficulties was also questioned in the supplementary submission from Concept Economics by Professor Ergas:

“For example, there have been significant declines in world commodity prices recently. These will undoubtedly affect macroeconomic conditions in Australia. Global commodity price movements affect Australia's terms of trade, exchange rate, gross national income, gross domestic product, and employment. Would Treasury also favour “precautionary” government measures against such movements – a return to taxpayer funded commodity price stabilisation schemes for agricultural commodities, for example?”⁸

1.31 Coalition Senators again find themselves in agreement with the views of Professor Ergas and fail to understand why the Rudd Government should be prepared

⁸ Concept Economics, *Submission 10a*, p1.

to go to such extraordinary lengths including committing up to \$28 billion in Commonwealth funds to provide a safety net for the commercial property sector and not take similar action for other important sectors of the Australian economy.

ABIP could increase Government debt by a further \$28 billion

1.32 Coalition Senators are concerned about the potential of ABIP operations to increase Commonwealth Government debt by \$28 billion.

1.33 ABIP in the first instance will have \$4 billion of capital being made up of \$500 million from each of the 4 banks and \$2 billion from the Commonwealth. However, in addition, ABIP can obtain a further \$26 billion from the finance market which will be guaranteed by the Government.

1.34 While this facility may never be used, its existence is a matter of concern to the Coalition Senators for three reasons.

1.35 Firstly, the scope of projects which ABIP may re-finance is vague and undefined. The Prime Minister, when introducing Ruddbank, tied the proposal to the consequences of a commercial property market collapse arising from the withdrawal of foreign banks from lending in the domestic Australian property market. However foreign bank withdrawal is not mentioned in this light in the legislation which however does provide for re-financing in other areas which are not defined. This may mean that the scope of ABIP re-financing could be extended beyond financially viable commercial property projects to other perhaps less viable investments.

1.36 Secondly, Coalition Senators are deeply concerned about the Rudd Government's propensity to increase Government debt, which is already approaching \$200 billion.

1.37 Thirdly the Government has not put in place an accountability process for ABIP to either a Minister or to the Parliament for example through the Senate committee process.

1.38 The addition of an extra \$28 billion in potential debt does not seem great to the Government, however Coalition Senators by contrast are mindful of the fact that it took the Howard Costello Government 10 years to pay out the \$96 billion debt left by the Hawke-Keating Government and are concerned that the ever-mounting debt incurred under the Rudd Government will impose a severe long term constraint on the Australian people.

ABIP exemption from the Trade Practices Act

1.39 The exemption of ABIP from the Trade Practices Act is another matter of grave concern to Coalition Senators and it would seem also to the Independent Senator Xenophon.

1.40 More fundamentally Coalition Senators were very disturbed to learn in evidence from the ACCC that there had been no meaningful consultation with the Commission about the implications of an exemption from the Trade Practices Act and that the ACCC had not been requested to provide advice to the Rudd Government about the consequences of such an exemption.

1.41 Within the proposed ABIP legislation, section 16 provides ABIP and its activities with an exemption from the Trade Practices Act. The exemption in section 16 invokes section 51 (1) of the Trade Practices and which has the potential for exemption from any of the competition provisions as outlined by Mr Cassidy from the ACCC during the inquiry hearings in Sydney:

Senator EGGLESTON – "...it seems to be some people's opinion that clause 16 would permit other behaviours beyond cartels, such as misuse of market power. If that were the case, that of course would be another matter of interest to the ACCC, I presume."

Mr Cassidy – "The way proposed section 16 is drafted, it does not specifically refer to just section 45, which deals with anti-competitive agreements; it refers to the competition provisions in the Trade Practices Act more generally. So, in the sense that it provides a shelter for conduct from the competition provisions, it is not only anticompetitive agreements but it could be conduct under section 46, abuse of market power. Indeed, the way it is drawn, it could be any of the competition provisions."⁹

1.42 Coalition Senators draw attention to the fact that the TPA's competition provisions and abuse of market power provisions are designed to protect Australian consumers.

1.43 Further Coalition Senators wish to state that their strongly held view that exemptions from those provisions should be limited in their use with the exemption given in section 16 being noted by the ACCC as unusual:

"...there are not all that many Commonwealth section 51 exemptions. In that sense it is an unusual arrangement."¹⁰

1.44 With the ACCC as the responsible agency for TPA monitoring and enforcement, it seems quite extraordinary to Coalition Senators that the ACCC's

⁹ Mr Brian Cassidy, *Proof Committee Hansard*, 14 April 2009, p 56.

¹⁰ Mr Brian Cassidy, *Proof Committee Hansard*, 14 April 2009, p 55.

involvement in the development of this legislation granting exemptions from the provisions of the Trade Practises Act was so trivial as revealed by the evidence of Mr Cassidy;

Mr Cassidy – “To be quite honest, the first we knew of the existence of section 16 in the bill was when we saw the bill, and that was when it was tabled. We did have some indication from Treasury, when we were talking to them about the requests from the committee for us to table emails, that they were giving serious consideration to the possibility of having a section 51 exemption, but the first we knew concretely that there was going to be an exemption was when we saw it in the bill.”

Senator EGGLESTON – “So you have not examined it in detail? You did not have much input into the development of it?”

Mr Cassidy – “No. Basically, Mr Gregson and I were dealing with Treasury on this. I can say that our discussions never really got past that fairly broad brushed general advice.”¹¹

1.45 Coalition Senators are very deeply concerned that when questioned about the exemption and ABIP’s potential impact on the market, the ACCC was unable to provide any detailed analysis of how necessary the exemption is or whether competition would be affected, because the Rudd Government had not requested such advice.

1.46 The failure of the Rudd Government to have not involved the ACCC as the agency responsible for the protection of consumer interests in the development of this legislation must be a matter of grave concern to all especially given the potential, as discussed, for conflict of interest and abuse of market power inherent in the composition of the proposed Board of ABIP.

1.47 These concerns appear to be shared by Senator Xenophon as the following exchanges from Hansard demonstrate;

Senator XENOPHON – “In the absence of those day-to-day governance details, we will not know how necessary the TPA exemption is and why it was required in the first place until those other details are in place. Is that a fair summary?”

Mr Cassidy – “To put it plainly, we cannot make that sort of assessment. Whether Treasury is able to fill in some of those gaps and therefore help you towards that assessment, I am afraid is something for Treasury. We simply do not have that information.”

Senator XENOPHON – “That is right. But, until you have that information, you cannot make that assessment?”

Mr Cassidy – “That is right.”

Senator XENOPHON – “To use that Donald Rumsfeld phrase: ‘it’s a known unknown’.”

¹¹ Mr Brian Cassidy, *Proof Committee Hansard*, 14 April 2009, p 55.

Mr Cassidy – “That is right. It is a known unknown.”¹²

1.48 In reference to the importance of the rules to analysing the pros and cons of ABIP, Senator Bushby questioned Mr Fahour, the interim CEO of ABIP, whether the rules would be available to the Parliament in full prior to debate on the legislation which he regrettably was not able to answer. While the rules were not made available in time for this report, Coalition Senators trust that they are made available before the debate in the Senate and believe that support for the Bill would be unreasonable with so much uncertainty surrounding this matter.

“Senator BUSHBY – “...I guess what the parliament has to do is decide on whether we accept, reject or amend the legislation. Given that it is relatively open on a lot of the matters that will apparently be dealt with in rules, will those rules be available to parliament in full prior to the decision being made whether to pass or amend the legislation?”

Mr Fahour – “I am not in a position to be able to answer that question, I am sorry. You would have to direct that question to the Treasury or the Treasurer’s office.”¹³

1.49 Coalition Senators again repeat their opinion that coupling the broad exemption from the TPA’s competition provisions with the 4 major banks majority market share of commercial property lending, the potential capacity for abuse can only be regarded as very concerning. Furthermore given the potential involvement of large sums of public money, it is unacceptable that the activities of ABIP not be monitored to the same degree as other public spending arrangements and private business.

1.50 In light of this, Coalition Senators are concerned that besides evidence of insufficient consultation, there is no requirement for the monitoring of ABIP’s actions and its impacts on the market by the ACC, nor is there any capacity for them to intervene even if the detrimental effects of such practices clearly outweigh any benefits derived from the exemption.

Senator XENOPHON - “What role do you envisage the ACCC will have in monitoring the extent of the exemption, how far the exemption goes and what its impact on consumers could be?”

Mr Cassidy – “We do not normally monitor section 51 exemptions. I suppose that is simply because even if—and I am talking in generality here—a section 51 exemption does lead to, say, anti-competitiveness or other detriments for consumers, there is nothing that we can do about them. That is a matter ultimately for government. We do not monitor section 51 exemptions and how they operate.”¹⁴

¹² Mr Brian Cassidy, *Proof Committee Hansard*, 14 April 2009, p57.

¹³ Mr Fahour, *Proof Committee Hansard*, 14 April 2009, p49.

¹⁴ Mr Brian Cassidy, *Proof Committee Hansard*, 14 April 2009, p 57.

1.51 After further questioning from Coalition Senators, these issues were once again brought to light by the ACCC whose statements further confirmed the belief held by Coalition Senators that support for this Bill would involve too much uncertainty.

Senator BUSHBY - "...I note that in one of your earlier statements you said that we need more information on how ABIP will actually work before you can provide some opinions on some of the aspects of it. I would say: so do we, because we are being asked to pass it into law with the same degree of uncertainty on how it will impact. Do you think that the ACCC needs to know more about it and how, particularly, clause 16 in part 4 of the bill will work and how ABIP will approach the issues of concern to you before it should be passed into law?"

Mr Cassidy – "The government, this is really telling me, are probably handballing this back into your court, the court of the Senate and the parliament. The government has made the decision in this bill to put in place the section 51 exemption. With that exemption there, there is really nothing that we can do in relation to the way in which ABIP operates, so from that point of view I do not think it is a question for us, if I can put it that way, to know more about the way ABIP is going to operate, because with the bill as it stands we will not be able to do anything in relation to it. In any case, if I might say so, I think **it is more a question for the parliament and the Senate as to whether they are prepared to pass the bill with that exemption and that state of affairs in place.**"¹⁵ [emphasis added]

1.52 Faced with uncertainty and the limitations on the ACCC to monitor ABIP, Coalition Senators strongly believe that the Government should consider implementing the recommendations put to the Committee by the highly regarded Associate Professor Frank Zumbo.

1.53 In his submission, Mr Zumbo presents three recommendations which would; require legislation that would establish any section 51(1) exemptions be accompanied by a "competition impact study"; empower and require the ACCC to systematically review and report on all section 51(1) exemptions currently in effect; and require that a competition impact study be prepared and tabled within three months of the ABIP Bill coming into force and every year after that.

Board composition

1.54 As already discussed the Coalition Senators are greatly concerned that having a Board composed of representatives of the four major banks each of whom will have the ability to veto any ABIP decision and who are major players themselves in the commercial property market will inevitably invite criticism. Worse it may also lead to

¹⁵ Mr Brian Cassidy, *Proof Committee Hansard*, 14 April 2009, p 59.

actual malpractice in the form of collusion, abuse of market power or other anticompetitive activity.

1.55 Coalition Senators are strongly of the opinion that the proposed composition of the Board is not in the public interest.

1.56 On first principles Coalition Senators are of the view that ideally the Board should be composed of independent Directors whose loyalties will not be divided but devoted solely to carrying out the objectives set by the government for ABIP or failing this that four independent directors be added to the Board to balance the presence of the four banks on the ABIP Board.

Advisory Panel

1.57 In evidence to the inquiry, the Committee was told by Mr Murray, Executive Director of Policy Coordination and Governance in the Treasury, that the Treasury was:

“..in the process of putting together a panel of financial experts that the chairman could call upon [for advice].”¹⁶

1.58 Mr Murray added that Treasury had;

“very strong advice...from Credit Suisse”, about the formation of ABIP which was described as being “very helpful “.

1.59 Mr Murray further added;

“we would like to be able to give advice to this chairman, but, first, that might compromise his position and, second, we do not have the expertise to be able to do that.”¹⁷

1.60 Coalition Senators were interested that Treasury is considering establishing a panel of independent advisers to the chair of ABIP on the grounds that Treasury itself lacks the commercial expertise to provide appropriate advice to the ABIP Board. Coalition Senators believe full details of the proposed appointment of advisers should be made public including the number of advisers to be appointed, the selection criteria on which they will be chosen, the length of their terms and remuneration.

¹⁶ Mr Richard Murray, *Proof Committee Hansard*, 14 April 2009, p 82.

¹⁷ Mr Richard Murray, *Proof Committee Hansard*, 14 April 2009, p 82.

Conclusion

1.61 Coalition Senators do not support the establishment of ABIP or “Ruddbank” as it is more commonly known.

1.62 Coalition Senators do not accept that Rudd Government has made any convincing case for the establishment of ABIP as a contingency measure to protect investment in viable commercial property developments should foreign banks withdraw from lending to that sector. In fact no evidence was presented confirming that any of the remaining foreign banks operating in Australia intend to withdraw from lending in the commercial property market. However Coalition Senators do believe Professor Ergas made a very convincing case that the establishment of ABIP would actually encourage the withdrawal of the foreign banks from the Australian Commercial property sector secure in the knowledge that ABIP financing was guaranteed by the Commonwealth to the tune of \$28 billion and that their equity would be returned in full.

1.63 The Coalition is deeply concerned that ABIP is exempt from the TPA and among its number of competition provisions, those related to the prevention of Cartel behaviour by market participants.

1.64 Beyond this, concerns have also been raised that ABIP might be open to misuse of market power.

1.65 Coalition Senators find it difficult to understand why the Government has not sought the specific advice of the ACCC in setting up ABIP and it would seem from the evidence given by the ACCC there was a deliberate Rudd government decision to exclude the ACCC from involvement in the process of determining the structure and legal framework under which ABIP would function. Coalition Senators believe that such a decision could only have been taken at Cabinet level and call upon the Prime Minister to explain to the Australian people the extraordinary decision to exclude the competition watchdog, the ACC, from being involved in advising on the legal framework in which the Rudd Bank would operate.

1.66 Coalition Senators also question the real purpose of ABIP. In early statements it was said that ABIP was to be established as a precautionary measure to deal with the impact of the withdrawal from lending of foreign banks to the Commercial Property sector. However no evidence was given confirming the intention of any foreign bank to withdraw from the commercial property market.

1.67 Coalition Senators note that in the actual Bill, scope for entering into re-financing agreements appears to be broader than commercial property in view of the following wording in section 7 (2) dealing with the objects of ABIP: “to provide financing in other areas of commercial lending through financing arrangements of a kind agreed to by the members of ABIP Limited“. Considering the broad general

wording of this clause Coalition Senators believe the Prime Minister has an obligation to clarify the proposed extent of ABIP activities so that the possible impact on Government debt can be evaluated.

1.68 As discussed Coalition Senators hold very grave concerns about the possibility of conflicts of interest and abuse of market power as a consequence of the composition of the Board of ABIP being representatives of the four major Banks and believe that at least the composition Board of ABIP should be broadened to include four independent members or ideally be composed of independent directors with no cross loyalty issues.

1.69 Coalition Senators are concerned about the absence of clear lines of accountability of ABIP to a Minister or to the Parliament as would be consistent with accepted principles of public accountability where large sums of public money are involved.

1.70 Coalition Senators are also concerned that ABIP, unaccountable and unregulated as it is, and with a Board whose independence of judgement could be open to question, has the potential to add \$28 billion to Commonwealth Government Debt on top of the \$200 billion plus potential Commonwealth debt incurred by the Rudd Government already.

Recommendation 1

Coalition Senators recommend that the ABIP Bill not be passed by the Senate.

Senator Alan Eggleston
Deputy Chair

Senator David Bushby

Senator Barnaby Joyce

