

MINORITY REPORT

BY SENATOR NICK XENOPHON

1.1 The key premise of the Australia Business Investment Partnership (ABIP) Bill is that the withdrawal of liquidity by foreign banks from the Australian commercial property sector is not only likely, but imminent. This bill is intended as a contingency measure to address the risk presented by a chain reaction of asset price discounting that would impact on the broader economy.

1.2 However, apart from the high profile withdrawal of the Royal Bank of Scotland, the premise of significant foreign bank withdrawals was not unequivocally substantiated through the inquiry process. While it must be acknowledged that comprehensive evidence to substantiate contingency plans can be difficult to produce, two points stand out:

- (a) The limited or lack of any evidence to substantiate the claims of risk;
- (b) At a time when all sectors of the economy are struggling, why this particular sector should benefit over others with equally legitimate and (in many cases more substantial) evidence based claims for support.

1.3 Thus, the bill should be closely examined at the level of its fundamental assumptions.

1.4 A further assumption that appears to be made by the bill, which raises concerns, is that the taxpayer carries responsibility for the costs of borrowing while any dividends are distributed to the shareholders. Specifically, if a deed of guarantee is called upon, this is funded by the taxpayer, but the taxpayer does not share in the profit generated by ABIP. Again, this fundamental assumption is worthy of closer examination.

1.5 In addition, this bill raises a broader issue of the accountability of banks to the taxpayer for their financial support. For example, when questioned, Mr Fahour indicated that there could be secondary benefits to the four major banks (Hansard: 14/04/09 page 46). However, in the context of this measure and the previous bank guarantee, it can be legitimately asked what is the moral mutual obligation of the banks? If taxpayers are effectively investors, what is their return?

1.6 In relation to specific provisions of the bill and unintended consequences, four are worthy of note.

1.7 Firstly, the bill provides for significant investments by large syndicates and clearly does not provide for small to medium size businesses. While much of the Government's rationale is that ABIP is to provide for large scale financial risk and flow on effects, it also presents arguments about protecting jobs in the current financial climate. Further, answers to questions from the Property Council of Australia and Mr Fahour indicate that they believe that ABIP may apply to all commercial property projects, including small and medium enterprises. For these reasons, it is not unreasonable to ask for clarification about whether this bill could also provide for small to medium sized commercial property investments, and if so, the circumstances where such investments would take place.

1.8 Secondly, the bill does not seem to provide for cases where a foreign bank may be a member of a syndicate that includes Australian domestic banks that are not represented on the ABIP Board. There is the potential for concern that the interests of the four major banks may not coincide with the interests of those remaining should a foreign bank withdraw from the syndicate. Further clarification is required on this point.

1.9 Thirdly, clarification is required in relation to status of residential property. Within submissions, differing views have been presented, varying from the exclusion of residential property, the inclusion of residential property when associated to commercial enterprises, and the possibility to extend beyond commercial property with the existing definitions. While the Government appears to desire flexibility to enable the inclusion of 'commercial property-like' situations, further clarification is required in relation to the link between commercial and residential property and any potential impact on residential property prices.

1.10 Associated with this point is the scope of current definitions and the impact this will have on the utilisation of the \$4 billion initial provision. While it was repeatedly stated in the inquiry that the hope for the contingency plan was that it would not be utilised, issues surrounding the breadth of definitions and the nature of eligibility criteria can have significant implications for the transition to the secondary funding provisions. Projections as to the time that it will take to exhaust the initial provisions would be important for those deliberating over their support for the bill. Further clarity on the conditions required to trigger the \$26 billion secondary provisions would be of assistance, as would projections in relation to this occurring within the two year initiation phase of ABIP funding.

1.11 Finally, the inquiry has failed to fully address concerns about the potential of ABIP to create distortions within the market. It has been argued that inadvertently ABIP may create incentives for foreign banks to withdraw from the market. The basis of this argument is that the interests of the main partners of the syndicate is not to lose a project through the withdrawal of a foreign bank, and hence will maintain values and supplement with ABIP funding. The response within several submissions to the

inquiry is that the decisions of foreign banks are not made considering Australian conditions at the micro level. That said, a similar argument could be about the withdrawal of smaller domestic banks to minimise their losses, which could result in greater power to the major four banks. The response of Treasury has been that this would most likely not be in the interests of the major banks, but specific safeguards are yet to be articulated.

1.12 It must be noted that the existence of ABIP provides the option for withdrawal in the context of a price guarantee for an at risk asset.

Senator XENOPHON - Just finally, there is an argument that ABIP might have the unintended consequence of actually giving foreign banks an incentive to pull out on the basis that, in terms of their own risk management, value will be retained if they pull out by virtue of ABIP being in place rather than hanging in there. What is your response to that? Has the Property Council done any analysis about that quite important concern?

Mr Verwer – Yes. The moral hazard criticism is probably the strongest of all those that are levelled against the ABIP proposal. We have looked at alternative mechanisms for dealing with that hazard, but they are messy and not necessarily convincing. That is to say that there would need to be some sort of corollary punishment applied to foreign banks that withdraw.

Senator XENOPHON – But you acknowledge that there is a real concern with ABIP that a foreign bank might perversely have an incentive to pull out because they know that they will get paid out in full?

Mr Verwer – We agree that it is a logical possibility.

Senator XENOPHON – It is a pretty key hazard, isn't it, in all of this?

Mr Verwer – It is the strongest argument against ABIP. That is why we have looked at solutions. We have not come up with one yet. However, as I note in the submission, we think that the factors which are driving the withdrawal of those foreign banks – that is, the risks associated with the new era of global financial protectionism, with foreign politicians saying, 'We want the money back in our own countries' – wash out or at least trump that particular argument to some extent. Nevertheless, we do not have the technical answer as to how we can make sure foreign banks do not try and use ABIP as their escape card from Australia.¹

1.13 The risk that foreign banks could try and use APIB as their 'escape card' from Australia has not been addressed in the Bill.

1 *Proof Committee Hansard*, 14 April 2009, pg 11-12

1.14 Further, concerns that there may be a tightening up of lending were not fully addressed in the submissions to the inquiry, especially in relation to restricting entry and it being perfectly legal for the four major banks to coordinate pricing. Such concerns should be addressed in a substantive way prior to this bill being voted on in the Senate.

1.15 There are also a number of practical matters that require a substantive response:

- (a) Further clarity is needed about the reporting requirements and responsibility of the Government appointed member of the ABIP Board. The crucial final vote of this Board member makes such information vital to assessing the independence and integrity of decisions that are made by the Board.
- (b) The Government has claimed that provisions under the Corporations Act will ensure that Board members will be required to act in line with the interests of ABIP and its shareholders, not the major banks that they represent. Throughout the inquiry, specific information in relation to these provisions was not provided in enough detail to allay these concerns.
- (c) Further information is required in relation to the day to day governance provisions of ABIP. Specifically, this relates to the necessity of an exemption for ABIP from Part 4 of the Trade Practices Act. Concerns have been raised that this exemption may lessen competition. In the absence of modelling, Treasury responses to questions that support the exemption on grounds that it will not detract from business competition, that it is a contingency and is temporary, are at best elusive and at worst lacking evidence. While the need for speed to respond to the global financial crisis is legitimate, this should not be at the expense of the proper scrutiny by bodies such as the ACCC. Proper scrutiny and independent assessment can prevent the timely and costly process of retrospectively fixing poorly prepared policy.
- (d) Answers to questions in relation to lending criteria and the loan to value ratio of ABIP against the banks require more substantive response. Submissions to the inquiry and Treasury's response have been unclear about the specifics of lending criteria, but to indicate that they are in the latter stages of development. Further, the possibility of funding outside the lending criteria requires additional clarification (Hansard: 14/04/09 pp 44-45). In the light of concerns about the potential of ABIP to prop up unviable commercial property enterprises, further information is required to allay these concerns. One possibility is for the Auditor General to provide independent oversight of lending criteria and projects that are commercially viability to provide additional safeguards to the taxpayer. Such initiatives would also need to be supported by adequate additional human and financial resourcing for the Auditor General's Office.

1.16 In the light of the concerns that have been raised and the lack of substantive information that has been provided in relation to these concerns, it is my recommendation that the Bill should not be supported in its current form.

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