The Senate

Standing Committee on Economics

Australian Business Investment Partnership Bill 2009

Australian Business Investment Partnership (Consequential Amendment) Bill 2009

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Senate Standing Committee on Economics

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Chapter 1

Introduction

Background

1.1 The global financial crisis has given rise to concerns that foreign banks may choose to concentrate their lending on their home markets, or be required to do so in return for assistance from their governments. This could mean that foreign banks withdraw funding from Australian commercial property projects, even when they still regard them as commercially viable. This market failure could in turn lead to unnecessary economic disruption and job losses if local banks do not fill the gap. If this led to 'fire sales' it could depress commercial property prices more generally, which might further dampen economic activity, such as by preventing small business using property as collateral for borrowing. The Government wants to have appropriate arrangements in place so that a prompt response can be made if these concerns are realised.

1.2 According to the Property Council of Australia, $30 billion (18 per cent) of the $165 billion in commercial property debt is provided by foreign banks and $16 billion (71 per cent) of the $23 billion in borrowings by Australian real estate investment trusts is in syndicated debt.[1]

Purpose of the bill

1.3 The Bill provides for the establishment of the Australian Business Investment Partnership Limited (ABIP) under the Corporations Act 2001, to address the potential risk of a funding gap in the commercial property sector due to an anticipated reduction of foreign bank financing.[2] The Explanatory memorandum describes ABIP:

> as a temporary, contingency measure to provide liquidity support for viable commercial property assets where financiers have withdrawn from debt financing arrangements as a result of the global financial crisis.[3]

1.4 The Bill also facilitates certain appropriations. The Government will be prepared to lend up to $2 billion to ABIP which, combined with $500 million provided by each of the four major domestic banks (ANZ, NAB, CBA and Westpac),

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1 Property Council of Australia, *Submission 9*, p 5. This is consistent with the estimate provided by ABIP's interim CEO, Mr Fahour; *Proof Committee Hansard*, 14 April 2009, p 38. A lower estimate was provided by the National Australia Bank: 'in December 2008, banks held over A$190bn of commercial property exposure, with an estimated 14% held by foreign banks'; *Submission 11*, p 2.

2 Bills Digest, 17 March 2009, p 2.

3 *Explanatory memorandum*, p 3.

will enable ABIP to onlend almost $4 billion. If additional funding is required there will be scope for the $4 billion to be supplemented by the issue of government-guaranteed debt of up to $26 billion. The initial finance provided by the major banks will not be guaranteed by the Government.

Conduct of the inquiry

1.5 On 19 March 2009, the Senate referred the Australian Business Investment Partnership Bill 2009 and a related bill to the Economics Committee for inquiry and report by 7 May 2009.

1.6 The committee advertised the inquiry on its website and in a national newspaper. A number of organisations, commentators, academics and stakeholders were also invited to make submissions to the inquiry.

1.7 The committee received 17 submissions. These are listed in Appendix 1. A public hearing was held in Sydney on 14 April 2009. The witnesses appearing are listed in Appendix 2. The committee thanks those who participated in the inquiry.

Outline of the report

1.8 The structure and governance arrangements for ABIP are described in Chapter 2.

1.9 There were essentially two strands to the evidence presented to the committee. The first was debate over whether ABIP was necessary or would achieve the economic goals set for it (Chapter 3). The second was whether there was a risk that ABIP could stray from its core responsibilities into inappropriate activities or lead to unintended consequences (Chapter 4).

1.10 Chapter 5 concludes that the bill should be passed.

Chapter 2

ABIP operations

Governance

2.1 The shareholders of ABIP will be the Australian government (with a 50 per cent stake) and the four major banks (each with a 12½ per cent stake). The board will comprise five directors, one appointed by each of the shareholders, with the government-nominated director being the chairperson.

2.2 Board resolutions must generally be unanimous. (The exception is resolutions to commence enforcement processes in relation to property of a borrower, which may be passed by the chair and three of the other four directors.) This requirement effectively gives the government nominee on the board a veto.

2.3 The shareholders of ABIP will enter into a Shareholders' Agreement which will detail governance arrangements for ABIP operations. To provide greater transparency, the final agreement and any amendments to it will be made public as soon as practicable.[1] A draft, prepared by Mallesons Stephen Jaques, was tabled in the Senate on 12 March 2009.

2.4 As soon as possible after the Bill receives Royal Assent, the Australian Government Solicitor will apply to the Australian Securities and Investments Commission to register the 'Australian Business Investment Partnership Limited' as a public company limited by shares.[2] This ensures that the directors of ABIP are subject to provisions of the *Corporations Act*. This requires them to act in the best interests of ABIP rather than in the interests of the bank (or government) which appointed them.

2.5 ABIP's annual financial report, audited by the Auditor-General, will be tabled in parliament.

2.6 On 20 February 2009, the Treasurer announced the appointment of Mr Ahmed Fahour, former National Australia Bank executive, as the interim Chief Executive Officer of ABIP.[3] The Government has not yet announced its nominee for the board.

Borrowing arrangements

2.7 The issuing of any debt by ABIP will be subject to the unanimous agreement of ABIP shareholders. Government-guaranteed debt will only be issued once the initial $4 billion funding is exhausted and will attract an appropriate fee (agreed by

1 *Explanatory memorandum*, p 10.

2 *Explanatory memorandum*, p 9.

3 The Hon Wayne Swan MP, 'Australian Business Investment Partnership Interim CEO Announced', *Media Release*, 20 February 2009.

shareholders) having regard to risk and liquidity factors and general market conditions at the time any such debt is issued.[4]

2.8 If ABIP has profits available for distribution, it will pay half year and full year dividends. Any 'first loss' will always be to ABIP's equity, including the provisions for bad and doubtful debts. After that if ABIP issues no debt, any subsequent losses will be borne by the four major domestic banks and the government, proportionate with their initial contributions.[5]

Time limit

2.9 ABIP is only intended to operate for five years. It will only be able to make loans for two years from its establishment and the maximum term of loans is three years.[6]

2.10 This limit is supported as a key feature of the scheme by some contributors to the inquiry:

> We give support on the basis that it is temporary, that there are the extraordinary circumstances and that a lot of our members are saying that they simply cannot get finance.[7]

> A fundamental feature is ABIP's limited tenor (ie. Five years; two-year availability window and maximum facility term of three-years). It is envisaged as a temporary solution in which to execute its mandate (if required), straddle the tight liquidity period and provide for refinancing back into the financial markets in an orderly fashion.[8]

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4 *Explanatory memorandum*, p 8.

5 *Explanatory memorandum*, p 12.

6 Sections 8(4) and 8(5) of the Bill. The maximum term can be extended by regulation.

7 Mr Harnisch, Master Builders Association, *Proof Committee Hansard*, 14 April 2009, p 27.

8 ANZ, *Submission 12*, p 2.

Chapter 3

Commercial property, the Australian economy and ABIP

Is ABIP needed?

3.1 A number of witnesses and submitters expressed concern about the broader macroeconomic ramifications if the commercial property sector were allowed to weaken significantly:

> …by not stepping in we could precipitate a broader problem, not in the property markets…but in the banking system itself. Remember that we still have a substantial proportion of bank loans underwritten by property. That is their collateral, so if we see a sufficient fall in property values then we start to have bank debt write-offs. They will lose equity and we will run into the sort of problem that we ran into in the late eighties and early nineties which caused a recession.[1]

> There is a clear risk that those foreign banks, in withdrawing their liquidity from the Australian system… could start a chain reaction of asset price discounting in Australia, which would impact on the broader Australia economy… It is an issue, not just for the commercial property sector but also for the general economy… because real estate is the collateral for the entire Australian banking system.[2]

> Without this legislation we may see a further reduction in confidence, a deeper economic downturn and a postponed economic recovery.[3]

> …withdrawal of finance from viable commercial property projects may have adverse effects on employment and investment in other sectors of the economy. [4]

> … all the anecdotes from all our members and from our own survey, which is part of the submission, indicate that finance is drying up… To see a precipitous fall in asset prices would be … disastrous for confidence… maintaining confidence is very critical in mitigating the depth of the recession.[5]

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1 Dr Frank Gelber, BIS Shrapnel, *Proof Committee Hansard*, 14 April 2009, p 19.

2 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 2.

3 Urban Taskforce Australia, *Submission 1*, p 1.

4 Treasury, *Submission 9*, p 12.

5 Mr Harnisch, Master Builders' Association, *Proof Committee Hansard*, 14 April 2009, pp 27-30.

> It is NAB's view that if the Banks and Government do not approach re-structuring pragmatically, particularly in syndicated situations, asset values could free fall, deepening the downturn and resulting in a flood of forced sales which will cause greater losses, business failures and increased unemployment.[6]

3.2 A contrary view was put by Mr Ergas:

> I do not believe that the evidence to date suggests that there is a looming crisis nor do I think that the evidence to date and historically suggests that even when there are cyclical downturns in commercial property prices that has contagion or spillover effects in the economy as a whole.[7]

3.3 The property and business services sector (contributing about 14 per cent in 2008) is an integral part of the growth of Australia's economy. The property and business services sector registered about 4.6 per cent annual growth since 1991 compared to 3.6 per cent growth of the economy during the same period.[8] Therefore the importance of the property and business sector to our overall economy should not be underestimated.

3.4 Urban Taskforce Australia, a group representing property developers and equity financiers, argued ABIP was crucial to Australia's economic recovery:

> The economy will pay a heavy price if this legislation is blocked. Without this legislation we may see a further reduction in confidence, a deeper economic downturn and a postponed economic recovery[9]

Access to Funding & Liquidity

3.5 ABIP is not designed to interfere with natural market outcomes to hold up prices, only to protect against undue and distorting over-corrections. As such, ABIP will act as a contingency measure which focuses on addressing liquidity gaps which arise from the withdrawal of funding from commercially viable assets and projects. That is, ABIP will fill the gap created by market failure where foreign banks withdraw and domestic banks are unable to increase their exposure to fill that gap because of their responsibility to maintain prudential standards placed on them by regulators.

3.6 Westpac have attributed the funding gap in the commercial property sector to:

- The high levels of leverage (high debt and low equity levels) which are characteristic of most major participants in the sector;
- The syndicated nature of most large debt facilities, and the participation in these syndicates of a number of foreign lenders;
- Major Australian financial institutions reaching industry concentration limits; and

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6 National Australia Bank, *Submission 11*, p 3.

7 Mr Henry Ergas, Concept Economics, *Proof Committee Hansard*, 14 April 2009, p 74.

8 Bills Digest, 17 March 2009, p 10.

9 Urban Taskforce Australia, *Submission 1*, p 1.

- A lack of liquidity in capital markets (particularly Commercial Mortgage Backed Securities) and other private sources of debt due to the effects of the global financial crisis.[10]

3.7 The National Australia Bank have described the situation like this:

> In the commercial property market, capital markets and private sources of funds have dried up, and Regional Banks have curtailed their growth ambitions due to large existing exposures and in some cases pending impairments. Refinancing risk is particularly elevated. This is compounded by the pressure on Foreign Banks to repatriate capital to domestic markets to shore up balance sheets eroded by losses from asset write-downs and write-offs. The four major Australian banks cannot solve the problem, due to industry concentration limits, and increasing capital requirements from credit quality downgrades.[11]

3.8 The Property Council of Australia has pointed out that where foreign banks refuse to refresh existing credit lines, many property owners and developers will be forced to unnecessarily liquidate commercially sound assets, increasing the risk of an artificial fire sale. The aggregate effect of this would be a delay of the cyclical recovery of property investment activity resulting in and caused by less new investment, slower economic growth and higher job losses.[12]

3.9 According to the National Australia Bank (NAB), over A$70bn of commercial property debt will require refinance in the next two years, of which A$50bn is syndicated debt. NAB's submissions quotes research that says that "an increasing number of foreign banks will… be less willing to refinance existing syndicate positions, placing pressure on corporates seeking funds" and that a recent Property Council of Australia member survey indicated that there is already evidence that some foreign banks are leaving our market.[13]

Commercial property prices

3.10 The Property Council warned that commercial property prices had fallen by 15-20 per cent in the past year and a further fall of around 15 per cent was in prospect.[14]

3.11 The establishment of ABIP is not intended to hold up property prices above their medium-term market equilibrium, but to prevent an overshooting. Treasury explained:

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10 Westpac, *Submission 14*, p 1.

11 NAB, *Submission 11*, pp 1&2.

12 Property Council of Australia, *Submission 6* p 4.

13 NAB, *Submission 11*, p 2.

14 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 11. A similar estimate of the recent fall in property prices was given by Dr Frank Gelber, BIS Shrapnel, *Proof Committee Hansard*, 14 April 2009, p 18.

> Withdrawal of finance from viable commercial property assets may force businesses to sell assets in a distressed sale, which could lead to a more rapid and disorderly fall in prices than would otherwise occur, resulting in prices falling below their underlying values.[15]

3.12 The Property Council of Australia noted:

> We do not believe that ABIP will prop up prices. From the very first announcement by the government, it was clear that, to the extent that there would be any rollover finance extended to an individual project, it would be on its revalued price, and all decisions had to be unanimous. The banks are not noted for lending money on the basis of projects which are overvalued. [16]

3.13 Vision, an industry participant, argue that ABIP is needed to smoothly transition the commercial property sector through the liquidity problems they are currently facing. Furthermore they argue that without responsible intervention an inflated boom market will return once the global financial crisis is over.

> The risk that is run in this sector is that no intervention now takes place and the industry shrinks as a result of lending practices. The flow on effect is that a boom market will be created once lending is relaxed and pent up demand is released. Under this irresponsible approach we will go back to the very boom and bust economies that economic policy is trying to smooth out. Shortages in land and availability of housing will create inflationary pressure that could be avoided by a sensible transitionary approach.[17]

Employment

3.14 The global economic downturn is already being reflected in the Australian labour market. Employment has stalled and the unemployment rate has risen from its low of 3.9 per cent in February 2008 to 5.4 per cent in April 2009.

3.15 Employment in the construction industry peaked at 995,000 in August 2008 and had contracted to 980,000 by February 2009. The Property Council has suggested that another 75,000 jobs may be lost if nothing is done.[18]

3.16 The Property Council suggested that around a fifth of these jobs might be saved with the stabilising influence of ABIP, but to prevent all of the job losses would require an injection of over $12 billion directly into the construction sector.[19] They

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15 Treasury, *Submission 9*, p 12.

16 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 9.

17 Vision, *Submission 4*, p 2.

18 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, pp 9&10, citing forecasts by Econtech and the Construction Forecasting Council, which take into account the stimulus package.

19 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, pp 2&3.

gave as a specific example, the Vision Tower project in Brisbane, where the withdrawal of a foreign bank halted the project and a result 600 employees were laid off or redeployed.[20] As the labour and property markets deteriorate, opportunities to redeploy workers will dry up.

3.17 Asked about whether the reduction in activity and employment might be a reflection of reduced demand in the economy rather than being related to cuts in the availability of finance, the Property Council replied it was 'overwhelmingly' due to lending restrictions:

> The vacancy rates in the Australian office sector are at historic lows. They are around 4.8 per cent at the moment. The average rate over the last 30 or 40 years is around 10 per cent…There is no oversupply in the resale sector. There is no evidence of an oversupply in the industrial sector. So we do not think there has been a big choking off of demand in the last six months. [21]

3.18 Similarly, the Master Builders Association believes that at least 100,000 direct jobs are at risk over the next 12 to 18 months.[22] While not offering a quantitative estimate, the Urban Development Institute of Australia reported:

> The lack of available credit for new projects is having a significant impact on employment in the development sector. Instead of creating jobs, developers are shedding staff because capital is just not available to invest in new projects.[23]

3.19 In his press release announcing the scheme, the Prime Minister said:

> Many of the 150,000 workers employed in the commercial property sector are tradespeople, such as plumbers, electricians and carpenters. Without action, a combination of weak demand and tight credit conditions could see up to 50,000 people in this sector lose their jobs… with flow-on effects to jobs in other parts of the economy.[24]

3.20 The employment estimate was produced by Treasury, who explained to the committee how it was calculated:

> Based on the cyclical behaviour of activity and employment in the commercial property sector in previous severe economic downturns of the 1980s and 1990s, without action, a combination of weak demand and tight credit market conditions could see economic activity in the commercial

20 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 9. For further information on the impact on the Vision Tower project, see The Hon Wayne Swan MP, *House of Representatives Hansard*, 18 March 2009, p 2098 and Louise Dodson and Robert Harley, 'It's all a bit rich', *Australian Financial Review*, 21-22 March 2009.

21 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 13. Similarly, Dr Frank Gleber from BIS Shrapnel said ' a lot of projects are not proceeding for lack of funding'; *Proof Committee Hansard*, 14 April 2009, p 20.

22 Mr Harnisch, Master Builders' Association, *Proof Committee Hansard*, 14 April 2009, p 30.

23 Urban Development Institute of Australia, *Submission 13*, p 2.

24 Prime Minister, *Media Release*, 24 January 2009.

> property sector decline by around one third with consequent job losses of up to 50,000.[25]

3.21 Mr Henry Ergas has challenged the claim that the proposal will protect these jobs:

> …changes in the value of existing assets in no way directly alter employment prospects. Indeed, were rents to fall, business costs would be reduced and that might improve conditions across a wide range of sectors. True, the development projects that would otherwise not occur may create some jobs. But why would those jobs be any more valuable than the jobs that could be created by using the $2 billion for other purposes, including cutting economically distorting taxes?
>
> The Government claims to be acting on behalf of the 150,000 people employed in the commercial property sector, many of whom are tradespeople such as plumbers, electricians and carpenters. But what of the hundreds of thousands of shop assistants, cleaners, delivery drivers whose jobs will now not be "supported" by lower commercial property prices flowing through to lower retail rental costs?[26]

3.22 However, the Property Council rejects Mr Ergas' assumption that rents would decline in line with falls in property prices:

> Rents are determined in terms of the supply of space and the demand for space, in our view. We do not believe that there is a nexus between the value of the asset and the amount that is charged for the renting of the space in that asset.[27]

Superannuation

3.23 More than a third of the equity in the commercial property sector is held by superannuation funds, representing about 10 per cent of aggregate funds in superannuation overall. A decline in the value of such assets would have substantial implications for the millions of Australians who have invested in superannuation funds with an interest in the sector.

3.24 An 'artificial' collapse of commercial property values (caused by the market failure discussed above) would flow through to the wealth held by over 10 million Australians in their superannuation. This will affect retirees who will have lower income, putting greater pressure on the social welfare safety net. It could also lead to those looking forward to retirement to try to save more by cutting back spending, further dampening activity.

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25 Treasury, *Submission 9*, p 13 .

26 Concept Economics, *Submission 10*, p. 13.

27 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 11.

Residential property prices

3.25 There has been some commentary about the impact of the economic downturn on the residential property sector and whether ABIP will address any of these concerns. For example, Dr Ian Harper, one of Australia's best known academic economists, said:

> …the difficulty is if commercial property developers find themselves in a position where they can't refinance existing loans. So this is whether it's for new developments or existing developments. They have no alternative but to sell down those assets, those properties. And if that produces a general downward pressure on land prices, that's where the cross-infection into house prices and house-land packages can start.[28]

3.26 Mr Verwer of the Property Council noted the increasing involvement of large developers (such as Mirvac, LendLease and Stockland) in building residential property complexes in the last 10 years and highlighted that the focus of ABIP is not to address risk in the broader residential property sector. Mr Verwer went on to say that, although these developers represent a small and pivotal part of the sector, broad scale domestic housing prices will be unaffected by the proposal.[29]

3.27 ABIP will only cross the boundary into the residential sector in cases where broader scale institutional investors seek loans from ABIP who have also moved into the residential sector and borrowed money from banks in order to take the risks to develop those master-planned communities and suburban developments. As this involvement is relatively small, ABIP will not have any material impact on residential housing prices.

Will ABIP be an effective response?

3.28 The majority of submissions and evidence provided to the inquiry argued that ABIP was a necessary and effective contingency measure to support the commercial property sector in the event of a withdrawal of foreign investment.

3.29 The Property Council are enthusiastic supporters of ABIP, believing it to be an appropriate response that deals with a strategic risk by quantifying it and managing it.[30] Their Chief Executive Officer said that his international colleagues believe ABIP

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28 ABC, *The World Today*, 28 January 2009, available at http://www.abc.net.au/worldtoday/content/2008/s2476285.htm

29 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 10.

30 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, pp 7-8.

is a far better policy than the schemes being considered by any other country with a similar focus. He commented:

> …the ABIP proposal will encourage Australian property investors to rotate back into domestic investment as soon as economic fundamentals correct themselves...What ABIP is doing is specifically identifying the implications of the withdrawal of a large chunk of strategic credit to Australia and the way in which that would artificially discount well-performing assets—well performing assets are the only assets that are addressed by ABIP—and the implications for the broader community. It is focused; it is elegant…[31]

3.30 The Master Builders Association also saw ABIP as providing some useful certainty for industry, commenting that:

> …confidence, in the end, is what is going to drive the Australian economy back into recovery.[32]

Committee view

3.31 The committee accepts there is a real danger of excessive cutbacks in foreign bank lending leading to unnecessary job losses and disruptive overshooting of commercial property prices. The creation of ABIP provides an effective tool to address this problem if it materialises.

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31 Mr Peter Verwer, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, pp 2 and 8.

32 Mr Wilhelm Harnisch, Chief Executive, Master Builders' Association, *Proof Committee Hansard*, 14 April 2009, pp 30-31.

Chapter 4
Criticisms

1.1 Some witnesses expressed concern about possible unintended consequences of ABIP. These include impact on competition within the commercial finance sector, the lending criteria that will be used by ABIP to assess commercial viability, the breadth of arrangements that ABIP could enter into and the perceived disproportionate risk being borne by the taxpayer. There was also concern about the level of parliamentary scrutiny of ABIP's operations.

Encouraging foreign bank withdrawal

1.2 One argument made against ABIP is that it may encourage foreign banks to withdraw because it will allow them to repatriate without the risk of losing money from Australian assets in which they have an interest. This was described by the Property Council as being regarded as the strongest argument against ABIP.[1]

1.3 This criticism appears to assume that ABIP would be stepping in to finance property assets at their full (original) price, rather than the current market price, and so foreign banks would have nothing to lose from selling on or choosing not to continue to finance an asset. The implication is that, if ABIP was not willing to finance an asset, that lender would realise a loss by leaving, which might persuade them to stay.

1.4 However, it has been made clear that ABIP would be lending based on contemporary market values not original values:

> From the very first announcement by the government, it was clear that, to the extent that there would be any rollover finance extended to an individual project, it would be on its revalued price, and all decisions had to be unanimous. The banks are not noted for lending money on the basis of projects which are overvalued.[2]

1.5 This criticism of ABIP was also firmly rejected by Treasury:

> …my very strong view is that this in fact will assist to keep foreign banks here, not the opposite…[3]

1.6 Their reasoning was as follows:

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1 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 12.

2 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 9.

3 Mr Richard Murray, Executive Director, Treasury, *Proof Committee Hansard*, 14 April 2009, p 81.

> ABIP is there in terms of its lender of last recourse to underpin some stability in the market…lending by ABIP will be more expensive than the market, it does give an incentive for the borrower to say, 'We do have this backstop but we can't be guaranteed by the backstop. We are already facing repricing, so the loans from the syndicates are becoming more expensive as they are rolled over. Therefore we would rather keep the syndicate together rather than being an easy exit arrangement for the foreign borrower.'…ABIP is not going to be, as Mr Ergas suggested, bailing out distressed assets; far from it. It will be concentrating on financially viable assets and they are the sort of assets you would have thought the foreign banks would want to stay in rather than bail out of. [4]

1.7 Mr Fahour, in challenging the criticism, was able to draw on his personal experience as a foreign banker:

> I think the existence of these contingency plans supports our financial system. Having in my past life once worked for a foreign bank as its chief executive in Australia, I can give you some of my experiences. When a foreign bank operates in our country, one of the reasons why they are here and want to stay here is the stability and liquidity that this country provides in doing transactions. So, firstly, anything that we do to support stability and liquidity actually encourages in the long term participants to operate in the marketplace. Secondly, one of the issues [with that idea]… is that any one loan would precipitate a complete withdrawal of a foreign bank…typically, a foreign bank will not leave a country just because one loan is up and they think: 'We can get this refinanced with ABIP, so let's pack our bags and go.' Typically, what you would find is most of the loans are a fraction of their total portfolio. Therefore, whether they leave Australia or not is a much bigger decision taken in foreign lands.[5]

Committee view

1.8 The committee regards the risk of ABIP encouraging foreign bank withdrawal as small and not warranting opposition to the bill.

Lending criteria

1.9 The precise lending criteria which ABIP will use to assess applications for funding are yet to be determined. Mr Ahmed Fahour, interim CEO of ABIP, has indicated that lending criteria will be developed which reflects the objective of ABIP being a low-risk lender to commercially viable projects. He said:

> We have the privilege in ABIP of being able to work with all of the big four banks and get the best of their risk management systems, knowledge and information on how to set up the lending criteria in such a way that, as soon

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4 Mr Richard Murray, Executive Director, Treasury, *Proof Committee Hansard*, 14 April 2009, p 81.

5 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, pp 41-42.

> as the legislation is passed and the doors are open, we are in a position to prudently lend to investment grade projects that are commercially viable. Of course, the commercial lending criteria of any sensible bank will take into consideration factors such as repayment ability, interest coverage ratios and loan to value ratios. We would also take into consideration the fact that property prices have fallen recently and therefore we would want an up-to-date market valuation because our job is not to artificially hold up prices; our job is to make sure that we lend prudently.[6]

1.10 According to the Government, the lending criteria will be 'appropriate, prudent, and broadly consistent with the lending criteria of the four major banks. They will be determined unanimously by all five shareholders.'[7] Properties located outside Australia, land banks, speculative development assets and rural property will fall outside the scope of ABIP's lending criteria.

1.11 Further, to protect the interests of ABIP shareholders, any major domestic bank that is an existing participant in a financing arrangement before ABIP, must maintain at least their existing level of financing in percentage terms. This will provide a safeguard to ensure that ABIP only lends on fully commercial terms.

1.12 This also ensures that, when ABIP lends to an organisation that does not meet all the lending criteria (which can only be done on unanimous agreement of all shareholders) the shareholders are all bearing further risk as a result. Mr Fahour explains:

> Let us pretend for a minute that the loan to value ratio that we will accept is 50 per cent and something comes along with 55 per cent [but] it meets a whole bunch of other criteria—it has really high cashflow coverage, it has a valuation that was done yesterday, it meets every other criteria and, on balance, it is commercially viable and investment grade. You want to have the flexibility for the board to say, 'This is commercially viable but it didn't meet that criterion over there.' …the board may not reject it on the basis that it fulfils the objectives overall.[8]

1.13 Mr Fahour sought to clear up some misapprehensions about the nature of ABIP's lending:

> ABIP is not a bad bank. It is not a US TARP. It is not a bail-out fund. It is not there to clean up the mess of bad lending. It is not there to do any of those things. It is purely a contingency company to prevent market failure if it were to occur and to support financially viable firms, not bad banks, not bad assets, not toxic assets—none of those.[9]

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6 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 36.

7 The Hon Lindsay Tanner MP, *House of Representatives Hansard*, 12 March 2009, p 2502.

8 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 45.

9 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 40.

1.14 Mr Fahour has indicated that the shareholders are currently developing the precise lending criteria and that the details may be available before the passage of the bill.

1.15 Dr Henry Ergas has challenged the assertion that ABIP's lending criteria will be consistent with the lending criteria of the four major banks. He says:

> If consistent with means "similar to", and ABIP's lending criteria are in this sense consistent with the criteria of the four major banks, it is unclear why ABIP's lending decisions would be any different from the decisions that the banks would take in the absence of ABIP. In turn, if ABIP's decisions are based on the same criteria as the decisions that would be taken by market participants, how is ABIP "correcting" a market failure? If lending will only occur under these circumstances, why would ABIP be required?[10]

Committee view

1.16 The committee is of the view that *in a normally functioning market*, it is likely that Australian banks would be in a position to invest in a commercially viable project when a foreign bank withdraws. However, ABIP, as a contingency fund and a lender of last recourse, is designed to finance commercially viable projects when this normal function of the market fails.

Conflict of interest issues

1.17 Some concern has been raised over whether conflict of interest issues exist when one (or more) of the four major banks form part of a syndicate with a foreign bank. If the market is functioning well and the foreign bank withdraws from the syndicate, another lender would usually take up the stake. If no other such bank was willing, the asset would be sold off and the value of the asset written down. If this scenario happened to an asset that met ABIP's lending criteria, it would be in the interest of any of the major bank(s) involved in the syndicate for ABIP to take up the stake to prevent the fire sale, thus 'holding up' the asset value.

1.18 As discussed above, this argument would have force were ABIP buying at prior 'book values', but ABIP will be buying at market values.

1.19 When asked whether a member of ABIP would benefit if they were part of a syndicate, a foreign bank pulled out and ABIP stepped in, Mr Fahour explained:

> … not only can they not have their own loans refinanced; they cannot reduce their size and position in that syndicate. [That said,] there are some secondary benefits. [11]

1.20 He indicated that he felt that these secondary benefits were appropriate given the $2 billion that the major banks contributed to the initiative in the first place.

10 Concept Economics, *Submission 10a*, p 2.

11 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 48 .

Competition issues

1.21 Mr Ergas regarded the information exchange between banks involved in their participation in ABIP as potentially anti-competitive. However, he conceded banks participating in syndicated loans are also sharing information about borrowers.[12]

1.22 Section 16 of the ABIP bill specifically renders the activities undertaken by ABIP, its shareholders, directors, officers, agents and employees in furtherance of ABIP's objectives exempt from the competition provisions of the *Trade Practices Act* (TPA).[13]

1.23 When asked whether the ACCC felt this exemption was warranted, ACCC Chief Executive Officer, Mr Brian Cassidy pointed to the potential that, in the absence of the exemption, the joint venture defences may be available to ABIP but that without further details such a hypothetical analysis would be impossible.[14]

1.24 Mr Cassidy pointed out that such legislative exemptions in Commonwealth legislation were unusual (but by no means unknown) and that no specific advice to the Treasury was sought or given regarding the particular implications of the inclusion of the clause, nor whether or not ABIP would potentially be involved in anti-competitive behaviour. Mr Cassidy said:

> 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.[15]

1.25 When asked if the exemption from TPA competition provisions may allow behaviour even beyond cartel-like behaviour, Mr Cassidy said:

> The way proposed section 16 is drafted, it does not specifically refer to just section 45 [of the TPA], 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.[16]

1.26 As the ACCC does not monitor Section 51 exemptions (such as that contained in Section 16) despite their obvious position as the best-placed expert in competition matters, these exemptions are ultimately the responsibility of the government to

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12 Mr Henry Ergas, Concept Economics, *Proof Committee Hansard*, 14 April 2009, p 66.

13 Treasury, *Submission 9*, p 21.

14 Mr Brian Cassidy, CEO, ACCC, *Proof Committee Hansard*, 14 April 2009, p 54.

15 Mr Brian Cassidy, CEO, ACCC, *Proof Committee Hansard*, 14 April 2009, p 55.

16 Mr Brian Cassidy, CEO, ACCC, *Proof Committee Hansard*, 14 April 2009, p 56.

monitor. When a state government grants a section 51 exemption, the Australian government has the power to override such an exemption, which is usually exercised on the advice of the National Competition Council.

1.27 Without the Section 16 exemption, ABIP would be forced to go through the time-consuming process of applying for authorisation from the ACCC to protect it against action under the TPA for anti-competitive behaviour. If the clause was not included, the authorisation process would be the only formal way that ABIP could be protected from action against it for anti-competitive behaviour.

1.28 When questioned about Treasury's view of these criticisms, Mr Richard Murray, Treasury Executive Director said:

> I do not believe it is a cartel arrangement—far from it. I listened to Henry Ergas [chairman of Concept Economics], and he made the point that there would be access to certain information, but under the shareholders' agreement there are confidentiality arrangements around that because this is an important issue. Certainly this is not intended as a cartel arrangement; it is intended as a lender of last recourse arrangement and as very much a short-term arrangement. You certainly would not want to override the competition principles governing the banking sector through an arrangement like ABIP, and we have tried to put in place safeguards against that.[17]

Committee view

The committee is satisfied that there are valid reasons, not least providing certainty about its operations, to exempt ABIP from the *Trade Practices Act*.

Broad scope

1.29 While the Prime Minister's announcement of the scheme only referred to lending for commercial property,[18] there is no restriction in the bill. Section 7(2) says:

> A further object of ABIP Limited is to provide financing in other areas of commercial lending…

1.30 Mr Fahour said:

> The second part of the criticism is that this should not be allowed to go beyond commercial real estate. It is not for me to make that judgment. Right now we are focused on commercial real estate, but it does have the ability, with all five shareholders, to allow it to go beyond commercial real estate. And it is up to you good folks to decide whether that should be allowed or not.[19]

1.31 This scope has been criticised in some submissions:

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17 Mr Richard Murray, Treasury, *Proof Committee Hansard*, 14 April 2009, p 81.

18 Prime Minister, *Media Release*, 24 January 2009.

19 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 48.

> The broadening of the scope has an adverse effect of the Australian market by actively discouraging regional banks that are not part of the ABIP, foreign financial service providers and possible new entrants from competing in the Australian market.[20]

1.32 Any such commercial lending would still require the unanimous support of the ABIP board.

Committee view

1.33 The committee acknowledges that concerns have been expressed regarding the ability of ABIP to make loans outside of the commercial property sector. However in view of the fact that:

i) ABIP is a temporary measure only able to make loans for two years from its establishment specifically due to the withdrawal of foreign investment and

ii) The Government chairs the board and unanimous support is required regarding the viability of a project in order for ABIP to make loans

the committee is satisfied that sufficient protections exist to prevent loans being abused and that in limited circumstances ABIP may wish to consider projects outside of the commercial property sector.

Parliamentary scrutiny

1.34 There has also been criticisms that the bill does not provide for sufficient parliamentary scrutiny of the governance structures, lending criteria and other rules governing ABIP.

1.35 Mr Fahour sought to ease these concerns, pointing out that the rules governing ABIP:

> …will be put through and they will have the enforceability of the Corporations Law. There will be directors. It is very unusual in the sense of a corporation to have rules in place that require a unanimous decision by all shareholders before one thing can be changed. That puts an enormous onus on anybody trying to change anything. I can assure you that trying to get four banks, four risk officers, and the chairman who is representing the Commonwealth and the taxpayer all to agree is not going to be easy. It is not going to be easy to get some of these loans through or some of these changes made. I worked for one company, and trying to get it to do something was hard enough with one board, let alone four. [21]

20 GE Capital Finance Australasia, *Submission 2*, p 2.

21 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 39.

Committee view

1.36 The committee is of the view that the prudential standards of ABIP will be sufficiently stringent, the requirement for unanimity in decision making will be effective, and the requirement for the four major banks to maintain their exposure in assets that ABIP lends to provide an effective framework to mitigating risk to the taxpayer. Combined with the chairperson's effective 'veto' of decisions, the requirement that the directors provide the Minister a copy of ABIP's financial report, directors' report and auditor's report (prepared by the Auditor-General) to be tabled in both houses of Parliament and the publishing of lending criteria and the Shareholders Agreement, the committee is of the view that the measures taken to help mitigate risk and provide sufficient parliamentary scrutiny of ABIP's operations are sufficient.

Chapter 5

Conclusion

1.1 The full ramifications of the global financial crisis are as at yet unknown. It may be that ABIP will not be needed, and indeed the committee hopes this will be the case. However, it is possible that global financial conditions will worsen, or their impact on the Australian economy become more deleterious. It is therefore prudent to have measures in place to ameliorate such threats. ABIP would be one example of such prudent insurance.

Recommendation 1

1.2 The committee recommends that the Senate pass the bill.

Senator Annette Hurley

Chair

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 Minster 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]

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[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.

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[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]

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[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

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[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

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[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'."

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[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]

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[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

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[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.

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[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 Minster 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

Australian Greens Senators' Additional Comments

1.1 The Australian Greens believe that the Australian Business Investment Partnership Bill (2009) contains a number of flaws relating to the uneven distribution of risk and uneven provision of benefits to industry between the private sector participants and the Commonwealth and in its proposed governance arrangements.

1.2 Consequently, the Australian Greens propose the following amendments to the Bill:

(a) A requirement that all officers of private sector participants in the ABIP i.e. property development companies and/or consortia who are applying for debt funding under ABIP; and the four shareholder banks, must not be paid greater than $1 million p.a.

(b) The sum of $1 million includes all remuneration paid, promised or guaranteed in any form, including through consultancy agreements and grants of shares or other interests, and including any payment made upon resignation or retirement, however described.

1.3 This amendment is designed to ensure that those industry participants who directly benefit (i.e. the commercial property development companies) or indirectly benefit (i.e. the banks) from the Commonwealth involvement in ABIP demonstrate corporate responsibility and reasonable restraint to the community by limiting excess wages. This approach is consistent with the responses required from companies receiving similar government support in other countries – for example the United States.

(a) A requirement that the number of ABIP directors increases to 8 and that the Commonwealth nominates four of the ABIP directors; with the remaining shareholders nominating one director each.

(i) A requirement that decisions regarding contract enforcement:

- Be made by 75% of ABIP directors; and
- That this decision is agreed to by at least two of the directors nominated by the Commonwealth.

1.4 This amendment addresses the need for the governance arrangements to reflect equity share in ABIP. The Commonwealth is providing 50% of the equity in ABIP while each of the four private banks each provide 12.5% of equity. This amendment ensures that the Commonwealth representation on the board of ABIP is commensurate with the relatively larger amount of equity contributed.

SENATOR BOB BROWN
AUSTRALIAN GREENS

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.

NICK XENOPHON

Independent Senator
for South Australia
7 May 2009

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Urban Taskforce
2	General Electric
3	Eureka Funds Management Limited
4	Vision
5	AMP Capital Investors
6	Property Council of Australia
7	BIS Shrapnel
8	Master Builders Australia Inc
9	The Treasury
9a	The Treasury Supplementary Submission
10	Concept Economics
10a	Concept Economics Supplementary Submission
11	National Australia Bank (NAB)
12	Australia & New Zealand Banking Group Limited (ANZ)
13	Urban Development Institute of Australia (National)
14	Westpac
15	Commonwealth Bank
16	Investment & Financial Services Association Limited
17	Associate Professor Frank Zumbo

Additional Information Received

Answers to questions on Notice

Question on Notice 1

Impacts of ABIP on Competition (Senator Xenophon, Hansard p. 83-84)

Senator XENOPHON asked: Secondly, did Treasury do any modelling on ABIP's impact on competition?

Mr Martine – ah, we did modelling on employment issues and we did modelling on pricing. I wouldn't necessarily categorise it as competition.

Senator Xenophon –OK. I really want to get through these…

Mr Murray – …and certainly, did we see competition as a concern? Well we saw it as an issue but in terms of a short-term contingency and lender of last recourse, we're not there to stymie competition but we recognise that it was an issue.

Senator Xenophon –…Why was the section 51 exemption considered necessary? And further what assessment of competition impacts should there be before granting section 51 exemptions in terms of Treasury's role? Why was the section 51 exemption used instead of the traditional authorisation route? Thirdly, what level of advice did Treasury seek from the ACCC on this whole issue of the exemption? Did you seek an assessment of the potential competition and consumer impact from the ACCC? Further, and will Treasury monitor the impact of that competition? Again, they're all on notice, I know you're busting to answer them…

Answer:

Treasury considered carefully the potential competition policy and Trade Practices Act issues in the development of the ABIP initiative (though no formal modelling was undertaken). These considerations led to the assessment that the use of the s.51 exemption was the most appropriate policy course in the circumstances. Firstly, there are a number of factors which limit any potential adverse effects on competition, namely:

- ABIP operates in a 'market gap' where other commercial providers are not able to provide finance due to the global financial crisis. Accordingly, ABIP is not taking business away from existing financiers. This is buttressed by ABIP's pricing policy which will be to charge at a small premium to the market.
- ABIP is a contingency measure – it may ultimately not write any loans at all.
- ABIP is temporary – it will only write loans during a period of up to two years.
- The Government is not subsidising ABIP, nor any of the four major banks which are co-shareholders.
- The Shareholders Agreement prevents ABIP directors passing confidential information back to their shareholders.

- ABIP would operate on commercial lines and hence is not taking on poorly performing assets to the benefit of other financiers.

In terms of the Trade Practices Act considerations, the judgement was made that in the absence of an exemption or authorisation, it was not possible to rule out a potential action against ABIP. It should be noted that action can be taken under the TPA not just by the ACCC, but third parties, and ultimately these would be matters determined by the courts.

A key objective of ABIP is to provide certainty to the commercial property sector that viable assets will be able to obtain refinancing. Clearly this objective would be undermined if there were legal doubts about the validity of ABIP financing on TPA grounds. Consequently, potential avenues of removing any such legal doubts were examined.

Consideration was given to the use of the authorisation process under the TPA. However, that process can take some months. Given the priority for ABIP to be operational as soon as possible, it was determined that the most appropriate option was a legislative exemption. This provides the combination of certainty and timeliness which are essential to ABIP's effectiveness.

In essence, the rationale for the legislative exemption is that the policy benefits of ABIP far outweigh the anti-competitive impacts (if any, noting the points made above). The TPA itself envisages that this judgement can appropriately be made by the Parliament.

It should be noted that the exemption from the TPA is limited in nature. For example, it does not permit collusion between ABIP and other financiers to fix interest rates for the commercial property sector. This is because such activity would not be being undertaken 'solely in furtherance of ABIP Limited's objectives…' or otherwise covered by clause 16(1).

As a part of the consideration process, Treasury discussed with the ACCC the features of the TPA at a fairly general level and the broad options available for addressing risks of actions against ABIP under the TPA. Given that the judgement was made to proceed with the legislative exemption for the reasons outlined, Treasury did not seek a comprehensive assessment from the ACCC on the competition and consumer impacts.

Post-implementation, Treasury will monitor the impact of ABIP on competition, along with ABIP's impact on the market more broadly.

Question on Notice 2

Moral hazard of triggering foreign bank withdrawal because of ABIP (Senator Xenophon, Hansard p. 84)

Senator XENOPHON asked: Has any work or any modelling or any assessment been done in relation to this moral hazard issue that even the Property Council acknowledged as a concern that there is a risk that, in the absence of other safeguards you could actually trigger foreign banks jumping out of the market by virtue of ABIP in terms of the perverse outcome?

Answer:

Considerable attention has been undertaken in designing ABIP to address potential 'moral hazard' issues.

There are a myriad of factors that may impact on the decision of foreign banks to exit the Australian market, including, for example, the fact that some banks are owned or controlled by foreign governments whose decisions may not be wholly influenced by the dynamics of the Australian market. Many foreign banks are facing difficult circumstances in their home economies, and have been under pressure to reduce their lending commitments and exposures generally, and in particular to pull liquidity back into their home markets.

One of the key factors driving the decision of foreign banks to enter a market is the stability and liquidity of that market. ABIP is designed to support and enhance stability and liquidity in the Australian financial system. Rather than supporting withdrawal, ABIP may therefore encourage foreign banks to stay in Australia.

ABIP will also provide an incentive for borrowers to encourage foreign lenders to remain in syndicates, as it will price at a small premium above the market. There will also be an incentive for the major Australian banks to discourage foreign banks from using ABIP as an 'easy exit' strategy from the Australian commercial property market, as their exposure would effectively be passed (in part) to the major banks via ABIP.

ABIP will be re-financing quality assets, not taking on poor credit risks. Hence, if a foreign bank withdraws from a borrowing that ABIP ultimately refinances, they will miss out on providing finance to a creditworthy borrower paying market price. In other words, they will withdraw on liquidity or strategic grounds, not risk or price.

Question on Notice 3

Taxpayer riskbearing and contribution to ABIP ***(Senator Xenophon, Hansard p. 84)***

Senator XENOPHON asked: There's a criticism or a concern that, in terms of risk, taxpayers bear more of a risk in terms of the contingent liability rather than the banks, that their (the banks) exposures are limited to their contribution. If you could take than on notice, as well whether it's disproportionate in terms of the risk to taxpayers as well as the benefits to taxpayers.

Answer:

While ABIP lending does not exceed $4 billion, all ABIP's funds will come from its shareholders and all profits and losses will be shared proportionately between the shareholders, commensurate with the initial financing (i.e. the Government will receive 50% of ABIP's profits and the four major banks will each receive 12.5%).

A decision for ABIP to raise debt from the capital markets will require unanimous agreement of all shareholders. Any debt raised from the markets will be guaranteed by the Government (for a fee), to facilitate ABIP raising sufficient funds to meet its needs. In addition, it is possible that a small proportion of the debt issued by ABIP will be subordinated (ranked lower than) the shareholder's initial loan funding. This is to avoid adverse capital consequences for the major banks and a counterproductive reduction in their lending in other sectors of the economy. However, the financial structure of ABIP will ensure that the Government receives a commensurately higher expected return on this small portion of subordinated debt. It is important to note that the equity and debt contribution from the four major banks are still at risk beyond the issuing of the initial $4 billion, and will be called on to fund any losses before the majority of the Government guaranteed debt is called.

Question on Notice 4

Bank deposit guarantee (Senator Bushby, Hansard p. 84)

Senator BUSHBY asked: Firstly, with respect to the answer provided earlier about the effect of the bank deposit guarantee, it seems to me like you're proposing a potentially market-distorting policy measure to address the effects of a market-distorting measure that had consequences. I'd just appreciate your thoughts on that.

Answer:

ABIP is designed to allow normal market adjustments to occur, such as re-pricing of risk and a tightening of lending standards. ABIP is aimed at filling a market gap arising from the potential lack of liquidity in the market, and thus helping avoid adverse consequences where markets are failing to work properly.

Question on Notice 5

ABIP concept origination (Senator Bushby, Hansard p. 84)

Senator BUSHBY asked: In terms of the overall measure itself, who suggested it? Was it actually an initiative of the government or did Treasury actually propose this as a way of addressing the perceived issue?

Answer:

The Government first started working on this particular initiative late last year, as part of its broader efforts to support the Australian financial system. As part of those efforts, the Government has had a range of discussions with the major banks over the past few months regarding actions the Government may take to address potential liquidity problems that may emerge.

The National Australia Bank approached Government late last year with its views on commercial property financing issues. Subsequently, the Government discussed commercial property financing issues with all four major banks.

The final proposed terms of ABIP were subsequently developed with the active participation and contribution of Treasury and the four major banks.

Question on Notice 6

Developing ABIP Rules (Senator Bushby, Hansard p.84)

Senator BUSHBY asked: In terms of the Rules that we've heard discussed earlier today by Mr Fahour, will Treasury be involved in the development of the rules? Has it been involved in any of the rules so far?

Answer:

Treasury has been actively involved in the development of ABIP's lending criteria in consultation with the four major banks. ABIP's lending criteria have been outlined broadly in Appendix 2 of the Treasury's submission to the Senate Inquiry. Treasury will continue to be actively involved in the future development of the lending criteria.

Question on Notice 7

Enforcing ABIP Rules (Senator Bushby, Hansard p.84)

Senator BUSHBY asked: How enforceable will those rules be? And what degree of parliamentary scrutiny will there be over those rules? What ability does ABIP to change those rules without parliamentary scrutiny? Particularly under clause 7's expanded focus and the level of activity itself given that a lot of assurances have been given today that is really is only a contingency measure and that it will only be lending on very strict criteria?

Answer:

The draft Shareholders' Agreement provides that:

- an application to ABIP to provide financial accommodation to any person will be assessed by ABIP in accordance with the Lending Criteria in effect from time to time (clause 2.3a); and
- the ABIP board may only approve applications to ABIP as authorised by the Lending Criteria and otherwise in accordance with the *Australian Business Investment Partnership Act 2009* (clause 2.3b).

The Shareholders' Agreement is a contract between the Shareholders and is enforceable under contract law.

ABIP's board will be responsible for ensuring prudent lending decisions in accordance with the lending criteria, subject to unanimous agreement. However, the Board will have some flexibility, both to relax certain criteria and to demand more stringent criteria where applicable. It should be noted that ABIP's board is required to act in good faith and in the best interests of ABIP, and that these duties are enforceable under the *Corporations Act 2001*. Appendix 2 of Treasury's submission provides a broad outline of the lending criteria.
The criteria are broadly consistent with those of the four major domestic banks. The lending criteria are still in draft form and remain subject to final approval by shareholders on a unanimous basis.
Any decision to expand the focus of ABIP beyond commercial property will require unanimous agreement by all shareholders. Any such decision will be made via an amendment to the Shareholders' Agreement and, as required by the ABIP Bill, will be made public as soon as practicable.

Question on Notice 8

ABIP Rules (Senator Bushby, Hansard p.84)

Senator BUSHBY asked: Typically is there any requirement for applicants for finance to have tried to get refinance from any of the big four before they actually come to ABIP?

Answer:

ABIP is a lender of 'last recourse' – that is, it will not operate where financing is available in the market. Before a loan can be made, the Board of ABIP will be required to assure itself that the commercial property assets are financially viable and that the market has failed. In particular, the Board will be required to assure itself for each creditworthy applicant that financing is not available from commercial providers, including the four major banks.

Further, borrowers from ABIP will have incentives to source alternative financing arrangements, given ABIP's loans will be priced at a small premium above the prevailing market.

Question on Notice 9

Emails between Treasury and ACCC (Senator Bushby, Hansard p. 84)

Senator BUSHBY asked: The communication between Mr Martine of Treasury and Mr Gregson of the ACCC are embodied in three emails.

Answer:

Please refer to the answer provided to Senator Brandis' Question on Notice on Hansard page E33 of the Senate Standing Committee on Economics of 26 February 2009.

Question on Notice 10

Exemptions under Trade Practises Act (Senator Bushby, Hansard p.84)

Senator BUSHBY asked: I'd also like to ask why in development of the legislation it was decided not to go for an exemption under the trade practices act that would have involved a public interest test, rather than the direct clause 16 exemption which was inserted into the bill which avoids the need for a public interest test?

Answer:

See the answer to Tsy No. 1.

APPENDIX 2

Public Hearings and Witnesses

Sydney, Tuesday 14 April 2009

- BRAKE, Mr Roger, Principal Adviser, Financial System Division
  Treasury
- CASSIDY, Mr Brian, Chief Executive Officer
  Australian Competition and Consumer Commission
- COOKE, Mr Trevor, COO/Senior Investment Adviser
  AMP Capital Investors Ltd
- ERGAS, Mr Henry, Chairman
  Concept Economics
- FAHOUR, Mr Ahmed, Interim Chief Executive Officer
  Australian Business Investment Partnership
- GELBER, Dr Frank, Chief Economist
  BIS Shrapnel Pty Ltd
- GREEN, Mr Benjamin John, Portfolio Manager, Debt Advisory
  AMP Capital Investors Ltd
- GREGSON, Mr Scott, General Manager, Co-ordination Branch, Enforcement and Compliance Division
  Australian Competition and Consumer Commission
- HARNISCH, Mr Wilhelm, Chief Executive Officer
  Master Builders Australia
- JONES, Mr Peter Raymond, Chief Economist
  Master Builders Australia
- JUDD, Mr Christopher James, Head, Property Funds Management
  AMP Capital Investors Ltd
- MARTINE, Mr David John, General Manager, Financial System Division
  Treasury
- MORLING, Dr Steven, General Manager, Domestic Economy Division
  Macroeconomic Group
  Treasury
- MURRAY, Mr Richard, Executive Director, Policy Coordination and Governance
  Treasury

- VERWER, Mr Peter John, Chief Executive Officer
  Property Council of Australia