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TUESDAY, 14 APRIL 2009

SYDNEY

BY AUTHORITY OF THE SENATE

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SENATE STANDING COMMITTEE ON

ECONOMICS

Tuesday, 14 April 2009

Members: Senator Hurley (*Chair*), Senator Eggleston (*Deputy Chair*), Senators Bushby, Cameron, Furner, Joyce, Pratt and Xenophon

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Farrell, Feeney, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, Marshall, Mason, McEwen, McGauran, McLucas, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams, and Wortley

Senators in attendance: Senators Bushby, Cameron, Eggleston, Fielding, Hurley, Pratt and Xenophon

Terms of reference for the inquiry:

To inquire into and report on:

Australian Business Investment Partnership Bill 2009 and the Australian Business Investment Partnership (Consequential Amendment) Bill 2009

WITNESSES

Committee met at 10.00 am

CHAIR—Welcome. On 19 March 2009, the Senate referred the provisions of the Australian Business Investment Partnership Bill 2009 and a related bill for inquiry and to report by 7 May 2009. The bill provides for the establishment of the Australian Business Investment Partnership Limited, ABIP, to address the risk of a funding gap emerging by refinancing loans relating to commercial property assets in Australia in situations where financing relating to those assets is not available from other commercial providers and the assets would otherwise be financially viable. The government will contribute $2 billion to ABIP which, combined with the $500 million provided by the four major domestic banks, will give ABIP access to $4 billion in undrawn loan facilities. Where additional funding is required beyond this, the bill facilitates a further appropriation which allows for the initial loan funding to be supplemented by the issue of government guaranteed debt of up to $26 billion. The bill includes provisions which will ensure that appropriate accountability, governance and reporting arrangements are applied to ABIP's operations and facilitate the interaction of ABIP's operations with the Trade Practices Act and the Corporations Act.

These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera.

[10.02 am]

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

CHAIR—Mr Verwer, would you like to make an opening statement?

Mr Verwer—Thank you very much for providing an opportunity for the Property Council to speak this morning. Good morning to all the senators. I also thank the parliamentary staff for organising the Property Council's appearance this morning. The Property Council supports the proposed Australian Business Investment Partnership—ABIP. We see ABIP as a contingency fund, a backup plan, that is designed to address looming liquidity traps that could be caused by the withdrawal of banks, particularly foreign banks, from the Australian commercial property sector. Ideally, foreign banks would maintain their presence in Australia. However, there is a clear risk in our view that the process of these foreign banks redirecting their credit to their domestic markets will escalate. That is because many of these foreign banks are now controlled by governments which have bailed them out, and implicitly but usually explicitly one of the strings attached to those bailouts is that those banks focus on their domestic markets. We believe this process has commenced and will continue over the next year. What we do not know is the quantum of credit that will be withdrawn from the Australian market—that is, the size of the liquidity trap.

The influence of Australian banks on the commercial property sector is a new phenomenon and a significant one. The banks have a very large strategic stake—around $30 billion of debt—extended to the commercial property sector. When we look at the syndicate market, where banks club together to loan to a commercial property entity, they control about 70 per cent of lending to the REIT—real estate investment trusts—market. This is a new phenomenon. In the five previous downturns that have occurred since the post-war period in the Australian economy in the commercial property sector—in 1961, 1974, 1981, 1991 and the smaller downturn of 2000—foreign banks were not significant players. Even though Australian domestic banks have a large exposure, a recent Merrill Lynch report showed that they only have half as much lending to the commercial property sector than they did even during the last downturn in the nineties. That gap has been filled by foreign banks.

That leads to the main thesis of our submission to you all this morning, which is that there is a clear risk that those foreign banks, in withdrawing their liquidity from the Australian system, will foment an artificial discounting of Australian asset prices and that this could lead to an artificial fire sale—that is, the withdrawal of that money could start a chain reaction of asset price discounting in Australia, which would impact on the broader Australia economy. So in our view it is an issue, I would put to you, not just for the commercial property sector but also for the general economy and general lending, and that is because real estate is the collateral for the entire Australian banking system.

So the risk is that in withdrawing those funds and creating this liquidity trap there would be any impact on the broader economy, and that would have an impact on jobs. There have already been 15,000 construction jobs lost in Australia since August. The Construction Forecasting Council, which released its forecasts for construction activity for the next 10 years, has predicted another 75,000 jobs will be lost. Even though ABIP does not specifically deal with the injection of new money into the commercial sector, it is a stabilising force. That is to say one of the virtues of the ABIP proposal is that it will encourage Australian property investors to rotate back into domestic investment as soon as economic fundamentals correct themselves. We think this is an important point.

One of the criticisms of ABIP is that it is designed to prop up asset prices. In our view, ABIP will not do that. There has been a major de-leveraging—that is, a reduction in the gearing—of commercial property entities over the last year and there has also been a correction of asset prices, in that prices have been falling in response to local demand-and-supply fundamentals. Our thesis to you this morning is that there is a strategic risk that the market will overcorrect when a very significant chunk of credit is withdrawn from the Australian market. So the issue is not so much the propping up of Australian asset prices; it is that they will artificially overcorrect and that this will infect the broader economy.

Australia is not Robinson Crusoe here. I met with my international colleagues in the last month, and all of their governments are working on addressing the rollover finance issue. The Japanese and the Americans are the most advanced. The Japanese government will soon announce a program similar to ABIP, whereby they will extend their existing business lending facility to specifically address rollover finance in the J-REIT market—that is, Japanese real estate investment trusts. The Americans are most advanced. The Obama-Geithner plans are extensive. They deal with a hierarchy of issues, from rollover finance to toxic debt; they are complex; and they are full of initials—the Troubled Asset Relief Program, the Term Asset-Backed Securities Loan Facility, the Public-Private Investment Program—but all of them are public policy solutions which aim to achieve two goals, and these goals are similar to those of ABIP. One is to create stability and confidence by ensuring that rollover finance is maintained within the commercial property sector, and the other is to mobilise new liquidity—that is, having stabilised the debt markets, to promote the velocity of capital, the re-injection of finance, into the sector. We believe ABIP does the same thing; we believe ABIP in fact does it in a simpler and more elegant fashion. Given the appropriate governance mechanisms, we believe that it will achieve a clear, strategic goal, which is to ensure that no artificial fire sale which infects the rest of the economy occurs in Australia. Thank you.

CHAIR—Thank you, Mr Verwer. You said that if the commercial sector experiences fire sale type conditions it will affect the broader economy. Specifically, will that include residential real estate? Is there a stronger link to residential real estate than to the broader economy?

Mr Verwer—In the last 10 years we have seen the major institutional investors move into the residential sector in a big way. In the past, most residential building in Australia has tended to be done by smaller companies, but now the likes of Mirvac, Stockland and Lend Lease Delfin are major players. They are also bigger risk takers—they create master planned communities and they also deal with retirement and aged care—and they also have bigger debt. So the answer to your question is that this is a much bigger risk than it has been in the past and, if a liquidity trap arises, that will affect the residential sector to a greater extent than it has done in the past.

CHAIR—Is that all over Australia, or are the kinds of companies you have described in particular cities or states?

Mr Verwer—It is all over Australia now. Lend Lease Delfin, for instance, has always been quite large in Adelaide. That is symptomatic of the institutionalisation of residential property investment and broad scale master planned development.

Mr Verwer—Can you name any of the foreign banks that were particularly active in the real estate sector?

Mr Verwer—Our submission lists 23 banks that our members said had been active. The biggest ones, we understand, have been the Royal Bank of Scotland and Citibank. We have provided some examples in the submission which, at the request of various investors and developers, we have masked. As we noted in the submission we are happy to go into greater detail with the senators, in confidence if necessary, to add more granularity to our submission about exactly how the withdrawal of those foreign banks would impact on particular developments and jobs and investment.

Senator EGGLESTON—What is special about the commercial property sector when compared to the numerous other businesses and sectors affected by the global financial crisis, all of whom are finding it more difficult and expensive to obtain finance? What is your special case?

Mr Verwer—I note that all sectors claim to be unique, so I do not want to say that we are unique when many sectors are facing credit problems. What is special about this sector is the huge exposure to foreign banks—that is, they control a much larger quantum of lending than is the case in other sectors, we believe. The other special feature is the fact that real estate is the collateral of the entire banking system. Small business loans in particular tend to be backed up by real estate; they are underpinned by real estate. So if a fire sale begins, there is no such thing as a controlled burn off. If artificial discounting or overshooting occurs, it will infect the broader economy. We believe that is particularly the case now because there is no more capacity in the Australian banking system. The big banks are being leaned on by the regulators to withdraw their exposure to the commercial property sector. Indeed, one of the virtues of ABIP is that it locks the big banks in to the commercial property sector.

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?

Mr Verwer—I do not have specific figures. What I can say is that mining tends to be a lumpy investment, so there is a large infiltration of foreign investment into that sector. But one of the unique features of the property sector is that there is such a broad number of individual assets spread all the way through the community—not just CBDs but also metropolitan and regional centres all across the country—that are exposed to foreign banking and the implications of the withdrawal of foreign banks.

Senator EGGLESTON—But they still have a very large percentage of foreign investment—that is my point. On page 6 of your submission you have listed, as you have mentioned, 23 foreign banks that have already withdrawn or are at risk of reducing their exposure in Australia. Would you take on notice, unless you can do it now, that I would like to know, for each of the 23 banks that you have mentioned, how much funding has already been drawn, what is the level of risk, what evidence you have for further withdrawal and what projects are affected. You can take that on notice because it is a complex question.

Mr Verwer—Thank you.

Senator EGGLESTON—This is related to foreign banks. What other foreign banks are there in Australia—this is other than those listed—that provide commercial property lending in this country? Have you covered all of them or are there others?

Mr Verwer—There are others but we believe that the list that has been included in our submission is the overwhelming majority.

Senator EGGLESTON—Isn't it the case that, irrespective of whether or not there is a financial crisis, any bank is at risk of reducing their 'exposure' to any area of financial lending? So aren't you being somewhat mischievous, in saying that there is clear evidence of foreign banks leaving, in the sense that what they are doing in fact is reducing their exposure, which is what any bank would do in any situation? It is not an unusual practice for a bank. So why should the public be asked to bail out commercial property when the banks are simply acting as banks always do and minimising their risk?

Mr Verwer—I would certainly be horrified if anyone thought that the Property Council's submission was mischievous in any way. One of the points that I would like to emphasise in response is that the big difference between the situation that we face now and the situation in previous downturns is this. Foreign banks can come in and they can go out—they can leave the country—but we gave them banking licences because they made a commitment to invest in this sector. In dealing with rollover finance, what we are really dealing with is the fact that the banks made a promise that they would extend finance to a particular sector, they set out rules, those rules are in a contract and now, because of the priorities in their domestic market and because they have actually been directed by foreign politicians to repatriate their credit to those domestic markets, some of them have decided—and it is a fact that they have already decided—that they will leave the Australian market. Our main thesis is more about the risk that this process will escalate.

Senator EGGLESTON—The ANZ and other banks pulled out of Vietnam because they saw it as a bad risk. It was just a banking decision. So why should we be running around at the moment trying to protect the property market when foreign banks have made a similar decision about Australia?

Mr Verwer—Because we do not believe that foreign banks are withdrawing because they see Australia as a bad risk. ABIP is only going to deal with commercially sound projects under the risk and credit criteria that will be established under the government's process. We believe that the major issue here is that we are on the verge of a new era of financial market protectionism and those foreign banks are actually withdrawing because they have been instructed by their new masters. As we note in the submission, many of the politicians who have propped up or bailed out the domestic banks of other countries have tied strings to that process. With ING Barings in the Netherlands, the Dutch government said, 'You will invest an extra €35 billion in this country this year in return for being bailed out.' Mervyn King, the governor of the reserve bank in the UK, said that the only way to do that is for them to net off their loan exposure, by which he meant repatriating the money from those overseas countries; in other words, 'Stop investing in Geelong and Glenelg because we want you to invest in Leeds and Leicester'. That is an artificial non-economic cause for the withdrawal of those banks. It has nothing to do with the Australian market fundamentals.

Senator EGGLESTON—With respect, Mr Verwer, it is nevertheless in the province of a national government to protect its national economic interests, and that is what those governments are doing.

Mr Verwer—And that is what we believe ABIP does, by protecting the Australian national interests.

Senator EGGLESTON—All right, but that is why they have given—if they have—those instructions. On page 16 of your submission, you compare ABIP to the US Troubled Assets Relief Program. Now, isn't the latter designed specifically for subprime toxic assets, and haven't we been told that ABIP is for commercially viable assets? Are you suggesting that ABIP is following the Americans' disastrous direction in this? Surely there is a huge difference between the subprime mortgage crisis and American toxic assets, and what you say are commercially viable properties in Australia?

Mr Verwer—There certainly is, thankfully. As I noted in my introductory remarks, the Americans are dealing with a hierarchy of issues on a continuum from rollover finance to toxic assets. The TARP is the headline program. The more specific, relevant program is the Term Asset-Backed Securities Loan Facility, which deals specifically with commercial real estate. It is different from Australia in that it is focused on commercial mortgage-backed securities, but it focuses on rollover finance or commercially sound investments.

Senator EGGLESTON—Okay. Given your concern about undervaluation during this period of financial difficulty, do you believe that a government agency should prevent overvaluation of property during booms; and, if so, how do you think that would work?

Mr Verwer—I do not know—

Senator EGGLESTON—If we are talking about undervaluation now, surely much of the reason we have this problem today is unrealistic overvaluation. So should we have some kind of government agency to prevent that occurring?

Mr Verwer—A government agency separate to ABIP—

Senator EGGLESTON—Yes.

Mr Verwer—to deal with overvaluation?

Senator EGGLESTON—Yes—let us dampen down the prices: 'Three- million-dollar houses in Cottesloe are really only worth a million, so let's push the price down.' Because you are suggesting that when they are lower they should be brought up to a median, average price, aren't you, in effect?

Mr Verwer—With respect, I am not. My thesis is that asset prices in Australia are correcting. They have already fallen by around 20 per cent over the last year, and various other witnesses before you—I think Frank Gelber will be appearing next—and other experts have said there is further to go and that asset prices will correct in terms of Australian market fundamentals. Our thesis is that they should not overshoot. As for the idea of a government entity being able to pick what the appropriate level of assets should be in terms of an upper end, I find it difficult to conceptualise how that could be achieved.

Senator EGGLESTON—It is difficult; I agree. But some people find the opposite very difficult too, because they think the market should be able to operate unfettered by government, and that is the system we have as the basis of our economy.

I have one last question for you, Mr Verwer: is it not the case that industry super funds have substantial investments in the commercial property sector; and, if so, could you detail that or take on notice to provide the committee with a schedule showing what the degree of investment is?

Mr Verwer—I will certainly come back to you with a specific figure, but the general figure is that, over the last decade, superannuation funds have invested more in the commercial property sector. It had got up to around 12 per cent in aggregate; it is down to about 10 per cent. There were a wide variety of funds investing different amounts, but 10 per cent is the figure I will put on the table until we come back to you with numbers that are more accurate.

Senator EGGLESTON—Thank you, Mr Verwer.

CHAIR—Mr Verwer, is it only industry superannuation funds or is it also private superannuation funds investing in property?

Mr Verwer—It is all the superannuation funds, as a general rule.

Senator EGGLESTON—I think that is a good question, so let us have a schedule of the spectrum of funds, and what kinds of funds they are, investing in commercial property, on notice.

CHAIR—Senator Cameron.

Senator CAMERON—I must say that I am a bit confused by Senator Eggleston's questioning. I may try and get some clarity from you, Mr Verwer. On the one hand, Senator Eggleston is saying that overseas countries have a right to intervene to protect their economy—and he has given examples of where that is having an effect on industries here. Yet, on the other hand, he is saying that markets should be allowed to operate unfettered by government regulations. This seems to be typical of the Liberal Party's confusion on this issue. Is the government's position on this fetter your industry, or is it an appropriate thing to do in the circumstances?

Mr Verwer—We see it as an appropriate response in dealing with the strategic risk. Business often criticises government for not acting strategically in identifying a risk, quantifying it and managing it. This is what ABIP does, and it does so in order to protect the sovereign national interest.

Senator CAMERON—Your thesis is more than a thesis; it is dealing with some practical implications as well. Another thesis that is out there is from Dr Henry Ergas from Concept Economics. His opinion pieces appeared in the *Australian on* 27 and 29 January. Are you familiar with the arguments that he has put forward in them?

Mr Verwer—Yes.

Senator CAMERON—He argues in his opinion piece on 29 January that the property fund may breach competition laws. Has your organisation had a look at this and made an assessment as to whether this is a breach of competition laws?

Mr Verwer—We have not sought legal advice on the issue. My understanding from the framing of the legislation is that the elements of the bill that deal with competition policy were designed to put beyond question whether in fact the ABIP entity would be a breach of those laws. It was a failsafe. We could seek specific legal advice if senators believe that would be helpful.

Senator CAMERON—The other thesis that Dr Ergas puts forward is in relation to the efficacy of this whole approach. He argues that there are better ways to deal with this problem. If it is a problem concerning the commercial operation of banks then it would be better to give everyone a tax cut, because we should not be supporting the banks. How do you see a general tax cut assisting your industry?

Mr Verwer—ABIP identifies a specific issue and then addresses it. In our view, it is an elegant solution. The irony is that, in speaking with our colleagues internationally, they all think ABIP is far better than what they are currently exploring themselves. A general tax cut is dealing with an economic stimulus; it is a response to the GFC. 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; and, assuming the government's procedures can be designed in a way that make them rigorous, we see that as a far better response.

Senator CAMERON—Henry Ergas also argues that putting in this fund will simply induce developers to play off their existing foreign lenders against the safety net that the scheme provides. Could you comment on that?

Mr Verwer—If only the property members were that powerful. Banks, and the foreign banks in particular, are always in the driver's seat here. They sought market share, they came into the market and they are an important part of that market. If they decide to withdraw, there is virtually nothing that can be done to stop them.

Senator CAMERON—Henry Ergas also argues that the impact on jobs is a furphy. Could you explain why you do not believe it is a furphy and why you are making this submission in terms of jobs?

Mr Verwer—Absolutely. Thank you for that question. I did not understand Mr Ergas's reasoning there. We see a direct nexus between jobs and the liquidity in the commercial property sector. ABIP deals with projects which are already underway, and we have provided a couple of examples, albeit masked at this stage, of typical scenarios where the banks have lent money for stages 1, 2 and 3. The banks are now having chats with our members and saying, 'Look, we're going to have to pull out; we'll go to stage 1, but for stage 2 and 3 the money is just not going to be there,' or, at least, 'Our chunk's going to be withdrawn,' and that undermines the feasibility of the entire project. Now, that has a direct implication for the forward employment of workers who were going to be employed in stages 2 and 3, and for all of the subbies and all of the designers.

There is one project which has been in the public domain, and that is the Vision project. It has been targeted recently for all sorts of reasons. Whether that project is viable or not is something that will be determined by the governance process under ABIP. But what is absolutely clear is that the withdrawal of a foreign banker stopped that project and, as a result, 600 jobs were lost. That is an empirical fact. So it seems to us that that at least makes the case that there is a nexus between jobs and liquidity, or debt, in the system.

My second point is in relation to future work. ABIP does not put new money into the system and therefore is not a source of funds for new investment. However, there is no oversupply, across the board, of office space, shopping centres, industrial projects, retirement villages or tourism and leisure facilities in Australia. As a percentage of GDP, in fact, spending on all of these assets has been falling for the last 30 years. There is no oversupply, unlike there was in the early nineties. Major investors want to meet the demand that is going to build up in that sector, which will automatically correct as we get over the current economic crisis. But they will not do so if they cannot even guarantee the financing of their existing assets and their existing projects, and that inevitably means that there will be a delay in their rotating back to investing in the sector and that inevitably means fewer jobs.

Senator CAMERON—Has Mr Ergas had any consultations with your council, or has Concept Economics sought any analysis from you to advise them of what is happening on the ground?

Mr Verwer—Not on this issue, no.

Senator CAMERON—I think Senator Eggleston has run the Ergas line pretty well for the opposition this morning. The Leader of the Opposition, Mr Turnbull, has basically said this is about propping up commercial property values and the market should be allowed to operate, as we have heard this morning. Is the market operating normally, and is this simply about government propping up property prices?

Mr Verwer—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. Even to the extent that some might be cynical about the banks, they are certainly not going to do so in the future. So we do not believe this is going to prop up values. Rollover finance will relate to the revalued asset price.

Senator CAMERON—Thanks.

CHAIR—Senator Xenophon.

Senator XENOPHON—Mr Verwer, can we talk about jobs first. You said that 600 jobs were lost in the Vision project, but your submission, at page 11, refers to 600 construction workers being ‘laid off or redeployed’. Which is it?

Mr Verwer—It is ‘laid off or redeployed’. Daniel Grollo from Grocon has said that he is attempting to redeploy those staff. I can actually ask Grocon, if you like, exactly what the percentage is.

Senator XENOPHON—If you could. There is a broader section of those jobs that have been lost, but those people may now be working in other sectors of construction. You made reference to a forecast of another 15,000 construction jobs lost since August and another 75,000 jobs to be lost in the future. Could you, on notice, provide further details of the organisation that made those predictions. To what extent do those forecasts take into account the stimulus package, in terms of the 20,000 homes to be built under the social housing project; the first home owners grant, which is not part of the stimulus package itself; and also the Investing in Our Schools Program, which will see a huge fill-up in terms of employment? To what extent have those forecasts taken into account those significant investments?

Mr Verwer—I will come back to you on that. The forecasts were prepared by Econtech and I have in fact directly quizzed them on that issue and asked them whether the forward forecasts of construction activity and the employment figures arising from those forecasts take into account the stimulus package. They have said, ‘Yes’.

Senator XENOPHON—Okay. It will be interesting to see that. You have also made a link between domestic and commercial property—that if you do not go ahead with ABIP, it will have an impact on domestic house prices. How is that so?

Mr Verwer—I certainly do not want to draw too long a bow there.

Senator XENOPHON—You have drawn it in your submission, though.

Mr Verwer—Thank you for raising it so that I can clarify our position. When it comes to the residential sector that I am referring to in the submission, it does not relate to broadscale cottage development. What I am specifically referring to is that area of investment that the large institutional players have entered into in the last 10 years. As I mentioned before, they have become a far more significant player in broadscale master planned communities which require large amounts of debt. That is the particular part, the commercial part, of the residential sector that I am referring to.

Senator XENOPHON—It is only a small part of the domestic property market, isn’t it?

Mr Verwer—It is small but it is pivotal and it is growing.

Senator XENOPHON—But it will not necessarily impact on the mums and dads out in the suburbs.

Mr Verwer—Broadscale domestic housing prices? Definitely not.

Senator XENOPHON—Okay. I just wanted to clarify that. What is your response to suggestions that shopping centres are currently overvalued and that, if shopping centre values fall, you would expect rents to fall. That would be the corollary of that, and ABIP would be propping up the rents that tenants would have to pay in terms of one of the consequences of ABIP.

Mr Verwer—One of the accusations made of the sector is that it is overvalued. My point is that the last year has seen a correction in those values to reflect the new supply and demand fundamentals that exist in the marketplace. Values have fallen by about 15 to 20 per cent in the last year as an aggregate number—there is huge variation across the asset classes and by geography—and there is a view that there is probably another 15 per cent to go. That is to say that the market is about ½ to maybe two-thirds of the way through the readjustment of asset prices in terms of shopping centres and the nexus between asset values and rents. 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.

Senator XENOPHON—Going on to the broader issue of loans, your concern is that loans will not be able to be rolled over. Is that not a problem for small- and medium-sized enterprises as well, and do you support ABIP as a vehicle for those small- and medium-sized businesses, as well as is being proposed for the larger commercial properties, because there is a squeeze on for the small businesses in this country in terms of financing?

Mr Verwer—Can I clarify the question, Senator Xenophon?

Senator XENOPHON—Yes.

Mr Verwer—Do you mean small enterprises that own property, or are you talking about general business lending?

Senator XENOPHON—Both.

Mr Verwer—We see ABIP as relating to commercial property across the board. We do not see it as a big end of town solution. In relation to smaller or mainstream commercial business lending, once again my point would be that it tends to be real estate that underpins those loans, whether it be the home of the business person or their other commercial investments. For that reason, if there is a general fire sale that artificially discounts the value of those assets, then that small business lending is potentially affected.

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 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.

Senator XENOPHON—If you have an answer on that before I vote on this I would love to hear from you.

Senator FIELDING—I would just like to draw on your expertise. You said that there have been 15,000 jobs lost since August, which is eight months ago. What percentage of those jobs were lost roughly due to lack of demand versus lack of funding which is commercially viable versus lack of funding because they are toxic debts?

Mr Verwer—The numbers come from the Australian Bureau of Statistics—

Senator FIELDING—I understand the figure of 15,000. You would know the property quite well. How many of those jobs, percentage wise, were lost due to lack of demand? Is it 50 per cent or 80 per cent? What is it roughly?

Mr Verwer—We cannot derive the answer from the ABS numbers, but roughly we would think that the majority of them have been lost because of a downturn in the sector which has occurred because of the halt in business lending in general.

Senator FIELDING—Demand is different to lending.

Mr Verwer—Yes.

Senator FIELDING—Demand is definitely different to lending.

Mr Verwer—We do not think it is because of a downturn in demand.

Senator FIELDING—So you think it is purely because of lending?

Mr Verwer—Overwhelmingly.

Senator FIELDING—The 15,000 jobs lost have been due to people pulling out their finances—

Mr Verwer—Yes.

Senator FIELDING—and not because there has been a downturn in demand and they are worried about—

Mr Verwer—No. 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. It varies very widely between markets. Vacancies have risen slightly, but most of that has occurred in the last few months as a result of the global financial crisis. 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. Certainly demand is moderating as a result of the global financial crisis and we expect that demand will fall even further in some sectors and some markets—the Canberra, Perth and Brisbane markets in the office sector, for instance. Vacancies will rise and demand will go negative, but it is not a major driver at the moment.

Senator FIELDING—Looking forward, let us say that ABIP gets up. In your submission you say there would be 75,000 jobs lost over the next two years. How many of those 75,000 jobs do you predict will be saved by the $2 billion the government puts in initially and the $2 billion put in by the four banks—and it seems odd that each party does not put in $2 billion, but we will not go there for the moment?

Mr Verwer—I would have to ask Econtech, who were in charge of putting together those forecasts, what their estimate would be. ABIP is not injecting new money into the system, and that is what would really protect most of those jobs. ABIP is a stabilisation mechanism. ABIP enables the property investors to rotate back into the cycle at a natural point, which I cannot pick—that is supply and demand fundamentals—rather than delaying it a further year because they have no confidence in the banking system and they cannot get the money even to roll over their existing project finance and to finance their existing assets.

If you like, we can certainly make an estimate of the impact of what that stabilising factor would be on jobs. The main reason for that 75,000 is that it is forecast that $20 billion will be withdrawn from the sector over the next two years. The $8 billion is added back because the residential sector will be quite strong, but the $12 billion or $13 billion withdrawn from the sector's cash flow will result in 75,000 jobs lost. An injection of stability will have an impact. I will have to come back to you with an estimate of what that impact would be.

Senator FIELDING—This is not new money; this is refinancing. Is it about 80-20? It would be 80 per cent of the 75,000 if it were new money, but this is existing money so do you think 20 per cent of those jobs would be saved? Just give me a guide.

Mr Verwer—If ABIP were established and it created the stability and confidence which it is designed to inject then 20 per cent would be plausible, but I would certainly want to come back to you on that.

Senator FIELDING—You are saying there is $12 billion that needs to be refinanced to try to look after 20 per cent of those jobs—and you will come back on that figure. Between $4 billion and $12 billion there is an $8 million gap there, isn't there?

Mr Verwer—The $12 billion is the amount that is sucked out of the system because of the downturn. I would have to take on notice the extent to which a stabilisation package impacts on jobs.

Senator FIELDING—I will ask the question another way. Why $4 billion? Why not $12 billion, $3 billion or $1 billion? I am curious. Did they come to see you about the actual dollar figure of $4 billion—$2 billion of taxpayers' money and $2 billion from the big four banks, which is $500,000 each? Did they come and see you about whether $4 billion was right? Did they pluck it out of the air or what?

Mr Verwer—No, they did not see the Property Council. I understand it was subject to a considerable amount of intense negotiation. The reason we are comfortable with the number is that $4 billion is effectively the start-up kitty and a further $26 billion can be raised in debt, which is backed by the government.

Senator FIELDING—That is $26 billion of taxpayers' money exposed. The issue I have is the risk here about how much of this refinancing is bad or toxic debts. I understand the Rudd government has said in the explanatory memorandum that these loans from ABIP would be provided provided the funding would not be available from other commercial providers but the assets would be financially viable. It says they are to be financially viable, but you are telling me the finance is not there because they are not financially viable. They are good returns. It is just because of the foreign investors. We have exposed $12 billion and we have $4 billion. It seems odd how you get $4 billion to try to cover $12 billion.

Mr Verwer—ABIP is not going to deal with toxic debts at all, nor should it. So the key here is to what extent the government's mechanisms, and the credit and risk criteria which are applied, will ensure that only commercially viable properties are financed.

Senator FIELDING—How do you define that?

Mr Verwer—And how they define that. That is a very important issue. Those rules are being established at the moment.

Senator FIELDING—I will leave it there I think.

Senator XENOPHON—Two things arise, I think, out of Senator Fielding's very pertinent questioning. Don't we need to know what the rules are as to what is commercially viable so that we know what the risks will be for taxpayers and also how the rules will actually apply? That is pretty fundamental, isn't it? We need to see the details of the rules in order to answer that fundamental question of commercial viability.

Mr Verwer—I understand that they are being developed at the moment. If the Senate requires that information then I am sure you will be able to—

Senator XENOPHON—Sure. Finally, Chair, Mr Verwer did indicate previously that there was some material that he may want to put to us in camera. I do not know whether we are going to take him up on that invitation.

CHAIR—We will just take a couple of minutes now, before the morning tea break, to do that, if you wish to.

Senator PRATT—Before you do that, I have a question. You submission talks about how residential property and commercial property are not totally separate markets. How do we prevent this package from being seen as just a bailout for big business and put forward the message that this is something other than just a bailout for big businesses, that it is indeed important for protecting value for ordinary Australians, ordinary mums and dads, and their homes.

Mr Verwer—Thank you for that. I am not sure I caught the entire question, but I will have a go at it. Senator Xenophon has drawn me up well in making a clear distinction between what might be called the mainstream mum and dad college residential market, and I want to make clear that we do not see that as an area where there is a strategic risk. We do not see a lot of asset price discounting there and we do not see ABIP as principally addressing that market. The part of the residential market which is covered by ABIP is where the broader scale institutional investors are moving into residential and borrowing money from banks in order to take the risks to develop mainly those master planned communities but also suburban developments. We think that the ABIP proposal does neatly distinguish between what might be called the broad scale investment market and the mum and dad market. We do not see it as a big end of town bailout mainly because those large investment-grade players are very widely held companies. For the most part they are superannuants. About 10.2 million superannuants capitalise the large developers, who then top up the project finance with debt from the banking sector.

Senator PRATT—Can you explain to us the link between the way in which lendings to ordinary homebuyers and new residential developments can be squeezed when the value of commercial property plummets?

Mr Verwer—When Senator Xenophon asked me before I had hoped to clarify that in no way was I indicating that we see the mum and dad market as being at risk to the same extent as the commercial property sector, and if our submission was unclear on this I apologise. In fact, we see minimal risk for the mainstream residential market, the mainstream mum and dad market, from the withdrawal of foreign banking finance.

CHAIR—Mr Verwer, do you wish to give any evidence in confidence?

Mr Verwer—Only if the senators had specific requests about the examples. I am happy to provide in writing or to you in person the details—that is, the name of the company, the name of the bank, the level of exposure and the impact in terms of jobs and investment in relation to those specific projects. I have permission from some of those who provided the information to provide that to you. I could not do it today, but I can if you request it.

Senator XENOPHON—That would be on a confidential basis.

CHAIR—I think you have a couple of questions on notice from various senators, including Senator Fielding with the 80-20 estimate and Senator Eggleston as well. If you could respond to those and indicate which, if any, parts you want to keep confidential, we will take that as correspondence.

Senator XENOPHON—I have a follow-on question from Senator Pratt’s in relation to the link between commercial and property markets. Your submission says:

- An artificial collapse of commercial property values could also squeeze the credit available to home buyers.

Is that something you are now resiling from or wish to clarify?

Mr Verwer—That is in relation to the total capacity of the sector. In the Q and A section of the submission we drew on the experience in the UK. In the UK we do believe that a contraction of the commercial market did extend to the quantum of overall lending including residential. We are not saying that is the case in Australia. We are not even highlighting that as a clear and present risk but it is a risk. I just did not want to draw a long bow there.

Senator XENOPHON—Thank you.

Senator BUSHBY—I will not ask any questions of this witness given the time.

CHAIR—Thank you, Mr Verwer, for giving evidence here this morning.

Proceedings suspended from 10.57 am to 11.15 am

GELBER, Dr Frank, Chief Economist, BIS Shrapnel Pty Ltd

CHAIR—Welcome. Thank you for coming to this inquiry this morning. Do you have an opening statement you would like to make?

Dr Gelber—Just a quick one. I had to rush off the text of it. In the comments, I saw as the primary objective preventing a financial crisis rather than stimulating development. I do not mind development, incidentally, but you have to do that only when the financial feasibilities work. At the moment, in all bar residential—and even in residential—they do not work, so that is not what this is about for me. My objective is to prevent a financial crisis.

CHAIR—In terms of preventing a financial crisis, is the commercial property sector, in your view, that important to the Australian economy?

Dr Gelber—Yes. If you recall the 1989 episode that we had here in Australia, most of the banks' loans were underwritten by property of one form or another. When we saw a fall in property values to the level at which they had to write off significant bad debts, the equity of banks was threatened in much the same way as it is being threatened overseas now, albeit more so. At that time, remember, Westpac almost went under. Commonwealth and ANZ were not far behind. NAB was not in big difficulty, but not for lack of trying—it was just too slow into the game. But the point there is that that was what caused the severity of the subsequent recession.

In Australia now, we have not got that sort of situation. We have not got a major property oversupply. What we have is a financial problem, not a property problem, but the banks feel they have too much debt exposed to property, want to reduce it and are aggressively urging the listed property trusts—who hold most of the institutional grade property in Australia—to reduce their gearing at a time when there is no equity to replace the debt. The banks are locked into that situation because, if they are aggressive enough about the sales of assets, prices will fall to levels at which we will start to have bank debt write-offs again, like we did in the eighties, this time for no good reason—last time there was a good reason. I think that is what we need to prevent at all costs because, if we go into that circumstance, we start to see problems in the banking system itself, and then we will have a big recession in Australia.

CHAIR—A factor in this that you and Mr Verwer mentioned is that, in Australia, property forms collateral for a lot of loans. It is asset backing.

Dr Gelber—Precisely.

CHAIR—If that asset falls in value, you get the snowball effect. That is a significant part of what you are saying?

Dr Gelber—Very much so. I am not really primarily concerned about what happens to the property markets; I am much more concerned about what happens to the economy in general.

Senator EGGLESTON—It is very interesting that you see this as a means of preventing a financial crisis, because many people believe that Australia does have a financial crisis. Do you agree with that?

Dr Gelber—No, we do not have a financial crisis. We have a severe credit squeeze.

Senator EGGLESTON—We have a credit squeeze—right. So, if we have got to this point without a financial crisis, why should we be taking this action in the presumption that there will be? It seems that a lot has gone into preventing a financial crisis. We are more than 1½ years into the global financial crisis. Do you really feel this is a justified step for the government to be taking?

Dr Gelber—Why don't we have a financial crisis? Because we have not gone over the top in property markets or investment in general. Had we done so, then we would be in the same situation as a lot of overseas countries now. However, there are large flow-ons from overseas to Australia, and so we have the credit squeeze, we have the collapse in share prices and we have the pressure particularly on the listed property trusts to sell property, with no buyers large enough to take out that property. So far, we have a severe credit squeeze. The banks feel they are locked into this situation and cannot force the issue—that is, force sales—because then they would have to write off significant equity. But if they break ranks we are in big trouble. We could go from the credit squeeze to the financial crisis if we were to see a significant fall in property values. Already property values have probably fallen by somewhere between 10 and 20 per cent, depending on the market—not residential but non-residential markets, pretty much across the board—and that is probably only halfway into the game.

But this is a market that is not clearing. It is not clearing, not for property reasons but for financial reasons, because it is not only debt that wants to get out; it is also equity that wants to get out. So the people who basically encouraged—no, twisted the arms of—the property sector to gear up during the boom are now running for cover. I am really talking about the super funds here, because they are the ones that own a substantial proportion of the listed property trusts and they were aggressively seeking total returns. The logic of our new version of the masters of the universe was to gear up to improve return on equity, and so the LPTs, if they did not do that, came under enormous pressure within the financial markets and the share market. So they went from 14 to 40. Now we are being asked to reduce. It cannot be done without equity.

Senator EGGLESTON—But in fact the property market goes through cycles, doesn't it?

Dr Gelber—Yes.

Senator EGGLESTON—I remember back in the late eighties there was a great depression in the property market. I had the misfortune to buy a house in Perth then and was charged 19 per cent interest, which I will long remember.

Dr Gelber—My commiserations.

Senator EGGLESTON—But the house was relatively cheap. The people who sold it took $40,000 off the price. So isn't the natural history of this sort of thing a cycle? Now we are in a trough, and what smart people do is just hang on because in due course the market will improve and their assets will regain value, whether it is property, shares or whatever. Does the introduction of this proposal show some lack of understanding of the normal cycles of the property market, and shouldn't the owners of this property really say: 'Okay, we are in a trough now. In five years time properties will have regained or increased their value'? So why should the government step in in the face of what are the normal cycles of the market?

Dr Gelber—I am not saying that we should step in to protect the investors, because you are right—the markets are cyclical. There are different sorts of cycles: demand cycles and supply cycles. The big one in 1989 was a supply cycle. This is just a little demand cycle. So let the buyer beware. My issue is not with that. The logic for anybody is to hang on if you can and ride it through. My issue is that by not stepping in we could precipitate a broader problem, not in the property markets—that is not what we are trying to rescue here—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. So my concern is not to protect the property market. I do not have a vested interest here—I am just an independent. My concern is that this could be a much broader problem than just property if we let it run.

Senator EGGLESTON—Going back to what I said earlier, if there were a collapse in the commercial property prices, why would a foreign bank try to sell its assets when they are clearly undervalued? Surely someone else would buy at the lower price. That is again the way the market works.

Dr Gelber—The problem is the sheer magnitude of the selling task now. The thing that could cause the banks to break ranks is an exodus of some of the debt funding. We are worried about the foreign banks in that respect. They have a much bigger problem at home than they have here, and so a lot of the reason for the collapse in both share prices and the currency last year was the withdrawal of funding as a result of distressed overseas companies and financial institutions cashing in their money and taking it home. So there is big pressure now on the foreign banks to take the money home, to rescue as much as they can. If that happens and nobody steps in, if the Australian banks are not willing to take in more funding—if they break ranks—we are in trouble.

Senator EGGLESTON—Can I ask you a question subsequent to that answer. What actual evidence is there for a significant withdrawal of foreign banks from the commercial property market? Can you name the banks and the level of withdrawal?

Dr Gelber—No, I cannot do that. I have seen numbers that have withdrawn some funding, but it is anecdotal.

Senator EGGLESTON—Can you name or detail them on the record?

Dr Gelber—No. I do not work in the financial markets. I read the papers, like you do.

Senator EGGLESTON—Well, list them. Let us hear what you have read.

Dr Gelber—I do not have that. It is not what I do. But for you, obviously, it is important to understand whether this is a real phenomenon or not.

Senator EGGLESTON—Absolutely.

Dr Gelber—I am just not the person to ask about that, but I am sure you will get plenty of people who will be able to answer that question.

Senator EGGLESTON—I have just two other questions. Do you know of any commercial projects that are actually facing difficulty refinancing?

Dr Gelber—Again, I am not in the finance area, so I do not know details on individual projects, because I do not hear about them until they hit the newspapers either. But I do know, first, that a lot of people are under significant financial pressure and that a lot of projects are not proceeding for lack of funding, as well as for lack of financial feasibility, incidentally.

Senator EGGLESTON—You mentioned super funds. Would you agree that it is the case that the super fund issue is central to all of this proposal, that what the government is really trying to protect is super fund investments?

Dr Gelber—I do not know.

Senator EGGLESTON—You did mention super funds as being major investors.

Dr Gelber—I did, yes. I slated some of the blame for the gearing up in the property area towards the aggressiveness of the super funds in seeking short-term returns, and now they are running for cover and do not want to know about the problem. For the super funds, I sympathise with the people who own the investments, but the super funds themselves have a large role to play in this. My feeling is that until the super funds come back in again we are not going to get sufficient equity into the market to allow a gearing down—that is, a reduction of debt levels—in the property area. So we need to wait until they come back in, and I would be encouraging them to come in, not out.

Senator EGGLESTON—Are you suggesting they have withdrawn?

Dr Gelber—As much as possible, yes, and they are not funding property either.

Senator EGGLESTON—But they are already in the commercial property market, aren't they?

Dr Gelber—They are, yes.

Senator EGGLESTON—And what I am suggesting is that that is the real point of all of this—protecting the superannuation investments of various categories of Australians, including industry super fund investments.

Dr Gelber—That is not my primary objective here. I am really concerned about the nature of the economic problem which could be a result of this. Yes, it would be nice to protect it, but if anybody can ride this through, the super funds can. The other point of the note that I wrote was that this is a transient problem. It is not going to take very long to solve. Actually, four or five years from now we are going to be building commercial property again, because there is not a major oversupply. So what we have now is a very short-term financial problem in a non-clearing market, which is dangerous for prices. So if super fund returns were to collapse and they sold at that level then they would crystallise those losses. But all they have to do is to hang on until the next upswing, and we know we need to get back to replacement costs before we can underwrite the next round of construction.

On a five-year horizon, they will not lose money. So I am actually not so concerned about the super funds. They have a lot of power in this situation. I am more concerned about the fact that we need to encourage the super funds back into the market to allow the property trusts to again gear down and become what they used to be, which were much more conservative vehicles for holding property rather than financially engineered geared-up vehicles which were maximising returns, which is what they had become.

Senator CAMERON—You say that we are in a credit squeeze and an equity squeeze at the moment, not a financial crisis. It seems to me that what you are saying is that we could very easily end up in a financial crisis if government says, ‘We will not intervene in a market failure.’ Is that the position?

Dr Gelber—Yes. I am not a natural at saying governments should intervene, but markets do what markets do. We cannot expect them to do what we would like them to do. We have to guide them into that proposition. I did mention in the submission a very good case of regulatory action in Australia which prevented us from going right over the top in the residential market when the Reserve Bank nipped the housing price bubble in the bud in 2003. The cost is that we have been underbuilding since then and we have a significant deficiency of stock. If there were no government intervention here—that is, support for the market—I would be really concerned that we could slip into a financial crisis in Australia. So, on that logic alone, I would say it is worth considering. But you are the ones who have to consider it.

Senator CAMERON—There has been other commentary saying that what the government are doing is foolish and that all we are doing is trying to prop up the property market. But you do not agree with that, from what I understand. You are saying that there is a bigger financial strategy at play and it is not just about propping up prices.

Dr Gelber—Yes. Prices will come back anyway eventually and those who are forced to sell in the interim will go broke but the ones who can hold through will be okay. Take the example of a Western Australian house. Even when the market falls, if you still have the house, at the end of the day, property values will exceed those falls. So if you can ride through the financial crisis, you will be okay. The problem here is an economic problem about the property market.

Senator CAMERON—It seems to me that the banks are going through a deleveraging process and that is part of the problem. They are trying to reduce their exposure. Are you aware of anywhere else where governments are intervening to try and deal with the financial deleveraging from the banks?

Dr Gelber—No. That is not my part of the ship. I do not deal with regulatory stuff. But what I do see is the pressure on the markets from the attempts to reduce gearing.

Senator FIELDING—I just want to get your feeling on the figure of $4 billion. Where did that come from, in your mind? You obviously comment a fair bit and read widely and look at the issues—where did $4 billion come from?

Dr Gelber—I have no idea. Is $4 billion the quantum of money that would be required?

Senator FIELDING—Just initially, yes.

Dr Gelber—I have no idea about the quantum.

Senator FIELDING—On the level that the banks are putting in, I suppose you are supporting the principle and not the actual amount. You are just sort of saying that the principle makes sense and that the banks would not do this on their own; they need the government to actually do it. They already have guarantees in place, but you are saying they are just not good enough to entice them to—

Dr Gelber—If I were in your shoes, if I could entice the banks to do it I would get the banks to do it. They are very aggressively trying to gear down out of this situation. In a market where they know prices will fall substantially over the next year to two years before they start to come back again, they think they are overexposed and are trying to reduce. How are we going to get them to replace any exiting capital? This is a question of where you tough it out and hold through. If you do that you will be okay.

Senator FIELDING—So you would not support the concern that some have expressed that the Rudd government is seen as a bit of a soft touch by the banks and they are actually getting out of this pretty cheaply?

Dr Gelber—Yes, I would. And I think it is your job to make sure that it does not work that way, particularly for the overseas banks. We are giving them an easy exit, aren’t we, if are just going to stand up and replace the money they want to take out—thank you very much! I am not saying we should do that. I am just saying that, if we do this thing, it is necessary for the economy, to prevent financial crisis and hence a more deep recession. But I think we should be very clever about how we do it, to make sure that it is not just an easy exit to anybody who wants to get out; otherwise, you are going to have to fund the whole banking system as well. They all want to get out.

Senator BUSHBY—Thank you, Dr Gelber. I think you got off lightly with Senator Cameron. If one of us had suggested that we did not have a global financial crisis he would have got stuck right into us.

Senator CAMERON—You can try if you like!

Senator BUSHBY—Or even if we had said that Australia was not facing a significant financial crisis yet. I take it from your answers to earlier questions that you are saying that you do not consider yourself qualified to speak on the issue of problems specifically as they relate to social property, but you are saying that, if you assume there is a problem with the commercial property sector, we need to do something to avoid it flowing into the wider economy.

Dr Gelber—Precisely.

Senator BUSHBY—So we may assume, then, that you are asking for some sort of solution to address the problem, if it exists, and that you are not advocating a particular solution?

Dr Gelber—Yes, that would be right.

Senator BUSHBY—You made another comment about it being our job to make sure that what we put into law is an appropriate vehicle to ensure that the problem does not eventuate, but you are not making any overly deep comment about the proposal itself—just that we need to do something in case there is an issue.

Dr Gelber—That is right. I am really just talking about the nature of the problem and the risks that we face.

Senator BUSHBY—You also mentioned that you would have some concerns if the solution that is put forward—and today we are looking at the ABIP bill—basically enables foreign banks to exit without any risk and to leave with a full investment, if that were one of the outcomes. Is that a fair summary of what you said?

Dr Gelber—That is a risk. I am not the person to talk to about the implementation of such a proposal because I am not integrally involved in the finance sector and how you would structure it. I am an economist and forecaster with a specialty in property markets, so I am really just looking at the situation and saying there is a real problem here. There is a risk that we will change—

Senator BUSHBY—The problem being the risk of the consequences if the commercial property market collapsed?

Dr Gelber—Precisely.

Senator BUSHBY—But, once again, you are not speaking on whether the risk of that happening is impending or alternatively whether the solution proposed is actually one that will head off that risk.

Dr Gelber—There are a few things I can say a bit more strongly than that. One is that this is a short-term problem in the scheme of things and that residential property is already picking up. Commercial property, sector by sector, differs, but five years from now, for example, Sydney and Melbourne commercial property will be building again and back at replacement cost. So this is not a problem of major oversupply, in which case you really would not want to intervene. If we ride this financial problem through for a specified period of time, say four or maybe five years, we will come back to a situation in which all these areas are viable again. So it is a limited horizon intervention.

We are supporting a market that is failing for specified reasons—that is, we do have a global financial crisis; we do have people trying to withdraw capital from the market, including overseas banks. It is essential to make sure that Australian banks hold firm through this—do not panic; do not break ranks—and, if enough capital were withdrawn from the market, that that would not precipitate a panic, because if that were to happen, and that is the real risk that I am talking about, then we would have a financial crisis—

Senator BUSHBY—A run on the banks.

Dr Gelber—and a severe recession. The real problem here is the attempts by individual financial institutions to withdraw money from the system and the response of the banks, so you need the banks on side with whatever you do. And so this, for me, is a job for the government in terms of holding the system together for a limited period of time until the financial aspects of the crisis recede.

Senator BUSHBY—I would agree that in times like this the government of Australia has a responsibility to look at these issues and make sure that it initiates appropriate policy responses. The difficulty is ensuring that the policy responses are appropriate. As an economist you know that it is very easy to look at what has happened and analyse that, but working out what is the appropriate thing looking forward is not always so easy. You talk about the big threat being the banks breaking ranks. If the proposal we have before us does encourage foreign banks to exit at no risk, isn’t that actually going to be self-fulfilling in terms of breaking ranks?

Dr Gelber—The problem is that a lot of the property companies are breaking covenants all the time and need to roll over debt on a regular basis and the market is getting shorter and shorter in its horizon. That does give the overseas banks an opportunity to withdraw funding, having triggered the covenants. If there is nobody to step in, then the assets are for sale, and maybe they are locked in, maybe they are not. But the task is not to cover the whole market; it is only to cover the extent to which foreign banks would want to withdraw.

Senator BUSHBY—The proposal we have before us covers the whole market.

Dr Gelber—Not the whole property finance market, because we have still got the Australian banks in the system.

Senator BUSHBY—The proposal will actually enable this new bank to lend for large projects, whether they have anything to do with foreign finance or otherwise. It covers the entire market.

Dr Gelber—I would say, then, the task is really to coordinate the activities of all the banks and make it understood that you are not going to stand in the market for anyone who wants to get rid of their debt, so that would require an agreement with the Australian banks. I would imagine they understand this anyway. They know they are locked into this situation and they must be petrified at the thought that they are going to have to replace exiting capital.

Senator BUSHBY—Right. I have a whole heap of questions I could ask but I only have a short period of time left. Do you see that the threat is of a collapse in the existing commercial property market, or that the threat is to the potential of new property being built?

Dr Gelber—New construction has already collapsed. The development market has gone, but not only for lack of finance. Certainly, initially, it was for lack of finance, but now, because the numbers do not work for new construction in, say, the commercial markets, rents and property values are falling and so you would not build them anyway. In many of those markets, even if you can get rents high enough to underwrite a project, there is no equity finance to take out the end project. So developers are stuffed—that is the technical term!—and there is virtually no development going on. The real problem here is for existing property already built.

Senator BUSHBY—Okay; that is what I was asking about. So the threat that you see that needs to be averted is that for existing property already built the prices may collapse with flow-on consequences?

Dr Gelber—Prices will fall anyway. But we have got a market which is heavily geared now, so if the banks, or several banks, were to force sales, the prices that would clear that market would be much lower than would need to happen in a more orderly situation. So this is not orderly anymore. We would then have prices falling to a level at which they would threaten the equity of the banking system.

Senator BUSHBY—The rationale behind this is foreign banks but, as I mentioned, the proposed new investment bank will cover not just foreign banks but banks across the board in Australia. Are Australian banks currently having liquidity problems in the commercial market? Are they having problems in terms of financing top end major commercial properties?

Dr Gelber—You would have to ask them. My observation would be that they want to get out of commercial property as much as they can, and they are putting enormous pressure on most of the listed property trusts, and indeed a lot of the smaller players, to reduce debt. So their revealed action is that they are putting a lot of pressure on the market to sell assets. I suspect they can get the money if they want to; they do not want to.

Senator BUSHBY—That is an internal decision of the banks, though, isn’t it?

Dr Gelber—That is right.

Senator BUSHBY—Is that something the government should involve itself in?

Dr Gelber—That is up to you.

Senator BUSHBY—Thank you.

CHAIR—Thank you, Dr Gelber, for coming in this morning.

[11.47 am]

HARNISCH, Mr Wilhelm, Chief Executive Officer, Master Builders Australia

JONES, Mr Peter Raymond, Chief Economist, Master Builders Australia

CHAIR—Welcome. Do you have an opening statement that you would like to make?

Mr Harnisch—Master Builders appears today in support of the Australian Business and Investment Partnership Bill. The building and construction industry is the key barometer of the Australian economy and the community's wellbeing. At the moment, apart from the resurgence of first home buyers in the residential market as a result of the first home owners $21,000 boost, all the indications are that conditions in the building and construction industry generally are deteriorating rapidly. Cyclical downturns are not new and are an unfortunate reality for this industry. But what makes this downturn different is the severity of the credit drought at a time when cash rates have come down dramatically. This lack of finance availability is confirmed by ABS data and Master Builders' own quarterly economic survey. This lack of finance availability can only stall economic recovery and in the short term make worse the recession. The impact will not only be felt by this industry but by other sectors of the economy because of this industry's multiplier effect. It can only result in further denting confidence, another critical factor that we see in determining the extent of the downturn and the timing of the recovery. This is why Master Builders supports ABIP.

To see projects currently under construction stop because of contractors' inability to obtain finance for the construction phase would be disastrous not only for the construction company itself but also for the building and construction industry more broadly, manufacturers, suppliers and of course the workers who would have to be laid off. It would also have a broader knock-on effect in the economy, particularly on confidence. Master Builders, in supporting ABIP has made a number of recommendations to improve transparency and accountability, in particular the introduction of a sunset clause—we suggest three years—to give effect to the intent that ABIP only be temporary; the establishment of transparent criteria for lending; the appointment of at least one independent director; and making public those who have been successful in obtaining ABIP loans.

CHAIR—Thank you. Comments in your submission indicate that you are concerned about the distortionary impact of the government's bank guarantee having eliminated non-bank lenders as a source of finance for the building industry. Do you see this as contributing to the problem—that the government is now coming at it from another angle?

Mr Harnisch—Our comments are based on the interaction we have had with those within the broader finance sector who have put to us the fact they are unable to get finance and therefore unable to on-lend. All we are doing is bringing to the attention of the Senate the fact that there are some in the finance sector who believe that it is having some distortions in the market. Really, what we are saying is that the Senate and the government should examine on a regular basis the length of time this unlimited guarantee can go for and the extent to which it may be having unintended consequences in the financial marketplace.

CHAIR—And yet you are supporting this bill, which gives another guarantee.

Mr Harnisch—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. If this provides confidence back in the marketplace in terms of last resort lending then on this basis and given the extraordinary circumstances we support the proposal.

CHAIR—You also say that it is imperative that ABIP not develop into a failed enterprise, like former state banks and development banks. Do you see it as a bank like structure or as a mechanism that provides finance that is missing as foreign banks withdraw from these kinds of industries?

Mr Harnisch—We see it as a last resort lending—in that sense insurance. Our comment really is that ABIP should not be picking winners. We believe that is improper. That would be very distortionary. It would penalise those who are able to get finance through the normal marketplace. Finance given on special criteria through the picking of winners is not something that we would support.

CHAIR—So you are reluctantly supporting this on the basis that the commercial building sector needs support now.

Mr Harnisch—Can I just correct that: our submission says we strongly support the bill.

CHAIR—Thank you.

Senator EGGLESTON—I am quite interested in your position. What commercial property projects are you aware of that are facing financial difficulties?

Mr Harnisch—Our support for ABIP is on the basis that we see it effectively as insurance. We believe that this will provide important confidence in the market not only in the construction industry but also in the finance sector. We would hope that it would never have to be drawn upon. In terms of actual evidence, for commercial reasons we have been unable to get that sort of data. But certainly all the anecdotes from all our members and from our own survey, which is part of the submission, indicate that finance is drying up.

Senator EGGLESTON—That is interesting. Do you think that is due to the withdrawal of foreign banks from Australia?

Mr Harnisch—I cannot comment on that.

Senator EGGLESTON—That is the rationale the government gives as underlying this piece of legislation.

Mr Harnisch—I am sure the government has done its homework.

Senator EGGLESTON—If you are supporting it surely you would have sought to confirm to what degree the commercial property sector depends on foreign bank finance.

Mr Harnisch—The construction industry is highly reliant on finance to fund projects. It is very cash dependent in terms of funding a project. The issue that has given rise to our support is to act to ensure that, in the eventuality of a catastrophic drying up of credit, there is a source of last resort lending to underpin the projects that are on foot. We do not see ABIP being a normal bank in that sense.

Senator EGGLESTON—Again, that is an interesting answer because you are not talking about an actual situation; you are talking about a potential situation. We have been told that this has been triggered by the withdrawal of foreign banks from Australia. Of course the building industry depends very heavily on finance but do you think taxpayers really care whether a building once valued at $100 million is now valued only at $80 million? Hasn't the decline in commercial property prices been less than the fall in stock markets yet no-one is seriously proposing putting up a scheme to underwrite and guarantee share prices. Why should they be doing it for the property market? Isn't this just the way the market works, and that is our economic system?

Mr Harnisch—In my opening statement I pointed out that the industry has always been cyclical but this is not a normal cycle. The cycle is being made worse by the global financial crisis, which is triggering an economic crisis, which is triggering unemployment—

Senator EGGLESTON—We all know that but you are talking about an 'if'. If this happens then you want this guarantee. It has not happened yet; you have said that yourself. Sure, all those things are happening but they are not the situation in Australia, according to you, as yet. So why are we putting in place this unusual guarantee of finance to the commercial property sector, which is contrary to market forces?

Mr Harnisch—For the same reason that prudent businesses and individuals take out insurance against an event that may occur—in the hope that it will never occur.

Senator EGGLESTON—The key word you used then was 'businesses' and it is a business risk that property values drop. It does not mean that the government comes in and protects everybody from a loss of value in any investment whatsoever. You cannot apply this principle across the board—that governments should be protecting every single Australian with any kind of investment, whether it be property, shares or whatever else.

Mr Harnisch—We look at this beyond just the individual project. We need to understand that commercial property in particular is now an important asset class in the financial market. It is an important asset class for superannuants and for self-managed super funds. To see a precipitous fall in asset prices would be disastrous for those people, it would be disastrous for confidence. I take your point that price correction will always occur in a market. You cannot stop it, but if we can ameliorate it, insure against it, and maintain confidence to ensure that the extent of the recession is not as deep and that the economic recovery comes earlier because of confidence, then it is a good thing to be doing. Certainly, as we all know, financial markets tend to have a herd mentality. We are very concerned to avoid a financial contagion should a loss of confidence in the market occur.

Senator EGGLESTON—Like you, our last witness talked about the cyclical nature of the property market and said that in five years time the property market will have recovered. Why not let the market cycle just run its normal course as it has over the years?

Senator CAMERON—More workers on the dole, again, eh?

Senator EGGLESTON—I am speaking to the witness, Senator; if you wish to interrupt, you may do so. They are not talking about an actual crisis; they are talking about a potential crisis. That is a different thing. This is a castle in the sky. Neurotics believe in castles in the sky; psychotics actually live in them. This sounds pretty psychotic to me because we are living in a possible scenario.

Mr Harnisch—As you would expect, I read a bit and experts better than me from overseas—the IMF and others—all seem to be universal in their view that we want to avoid a 1930-type depression in terms of length and depth, and that these sorts of stimulatory packages and insurances that are being put up by governments are worth doing. We on balance agree with that proposal. As we put in our submission, we also believe that the market should be allowed to operate but, unfortunately, we are in a set of economic and financial circumstances where the market is going to take a long time to achieve a rebalance or an equilibrium. Any matter that can stop the extent of that and the earlier we can get back to a normal market-based solution the better. In the meantime there is merit in putting in measures that will help avoid catastrophic consequences.

Senator EGGLESTON—Thank you.

Senator CAMERON—Mr Harnisch, can you understand why anyone would be arguing that the market should be allowed to operate, given the global financial crisis? Should the market simply be allowed to operate as if there were no global financial crisis?

Mr Harnisch—If there were no global financial crisis there would be an argument that the market should be allowed to adjust, which it always has done in the past in terms of price corrections, wealth shifts and production to clean out the economic system et cetera. But we are in a totally different situation and therefore it does demand different solutions to ensure that in Australia in particular, where we are much better placed, governments and industry work together in making sure that we limit the extent of the economic slowdown.

Senator CAMERON—You and your organisation have been strong supporters of the market system in the past, haven't you?

Mr Harnisch—Yes, we support the market, but obviously there is a place for appropriate government intervention. We are not a total free market organisation.

Senator CAMERON— would you describe the government intervention that you are supporting as psychotic, as a senator Eggleston has described it?

Mr Harnisch—We see it as appropriate insurance. It is about last resorts, as we read the bill. We believe that we need to look beyond the individual project; we have to look at commercial property as an asset class in the financial system and the important role that that plays in terms of not only the economy but also individuals' superannuation.

Senator CAMERON—Would you support the arguments being put forward by, say, the Leader of the Opposition that there is no validity to the argument that tens of thousands of jobs could be lost if there is this loss of confidence in the financial markets?

Mr Harnisch—We are very concerned about the loss of confidence because maintaining confidence is very critical in mitigating the depth of the recession or economic slowdown and confidence, as we see it, is critical in terms of bringing forward or stalling the economic recovery. Confidence, in the end, is what is going to drive the Australian economy back into recovery.

Senator CAMERON—Was Dr Henry Ergas consulted or approached by the MBA in terms of the analysis of how this global financial crisis is affecting the building industry?

Mr Harnisch—No.

Senator CAMERON—Has Concept Economics contacted you?

Mr Harnisch—No, they have not.

Senator CAMERON—Would you agree with the proposition that Dr Ergas puts forward that basically the funds are going to protect poorly managed companies and they are basically protecting deteriorating balance sheets?

Mr Harnisch—My reading of the ABIP bill says that it is for projects that are viable. That is what we would support, and obviously we would not support ABIP funding projects that are not financially viable.

Senator CAMERON—Dr Ergas said that the projects that are at risk are those that are most marginal but the property council has said that many projects are at risk, not just marginal projects but financially viable projects. Is that your understanding of the situation?

Mr Harnisch—Yes. What we are hearing from our members is that even contracts that are triple-AAA rated by the financial sector are being affected by the credit drought. Not only can they not get money; they could not get it even if they were prepared to pay premium basis points above the marketplace. So there is a credit drought, and we are very concerned that that will have knock-on effects, particularly in terms of confidence and, of course, the ability of the economy to recover in due course.

Senator CAMERON—Could you just tell me how this lack of confidence and the drying up of finance would affect jobs in the broader industry?

Mr Harnisch—The survey that we have just completed for the March quarter paints a very bleak picture in terms of builders expectations. Our analysis shows that at least 100,000 jobs are at risk for this industry over the next 12 to 18 months. The survey shows that in terms of the slowdown in this industry the worst will occur later this year until about August 2010. So this industry, certainly for the next 18 months, will see a very severe downturn. Unfortunately, that has significant consequences for jobs, and if it continues to be played out for two quarters in a row as our members expectations are showing, 100,000 jobs are certainly at risk.

Senator CAMERON—Are those 100,000 jobs direct jobs or is that the multiplier effect?

Mr Harnisch—No, they are the direct jobs of mainly tradesmen, but of course it has a knock-on effect in terms of designers and other professions who are at the front end. The other evidence we are getting is from architects and the consulting engineers—they have no major projects on the books. It is usually six months to one year ahead before construction starts, so if they do not have any major projects on their books, then obviously the contracting sector will not have any work down the track.

Senator CAMERON—So if this bill is blocked and confidence falls in the industry with the potential of 100,000 direct jobs being lost, would those jobs predominately be in the outer suburbs of Sydney and Melbourne?

Mr Harnisch—In the main they would certainly be in the capital cities where the major projects tend to be.

Senator CAMERON—If we went that far, would that delay the overall economic recovery?

Mr Harnisch—Certainly, because the construction industry has a proven track record in driving the recovery.

Senator CAMERON—So given all of those issues that you have raised, this is a reasonable proposal by government to try and shield the economy from the worst aspects of the global financial crisis?

Mr Harnisch—We believe that it is so, on the basis that it is, as we see in the bill, last resort lending. We see it, therefore, as insurance. Therefore, it does provide confidence to the marketplace that viable projects do have access to finance, even though it is at a higher premium, as I read it in the bill. That must be a good thing for the construction industry and for the finance sector in terms of providing and underpinning confidence.

CHAIR—Senator Bushby.

Senator BUSHBY—You mentioned in the context of ABIP that you hoped it would not have to be drawn upon and that it was a lender of last resort. Have you actually had a close look at the bill?

Mr Harnisch—Yes. I have read the bill and the explanatory memorandum.

Senator BUSHBY—As I understand it, I think clause 7 of the bill allows ABIP to set up to be as active as it likes. There is no limit to what it can do. It is my understanding that it will probably be active than in the commercial market, will definitely be drawn upon and will not be a lender of last resort. Does that change your view at all on the need for a vehicle such as this?

Mr Harnisch—In our submission to the Senate we have argued that the criteria for lending should be transparent to ensure that it does not compete in the normal marketplace. Our view is that we take the explanatory memorandum as read that ABIP is a temporary measure and is a last resort for viable projects.

Senator BUSHBY—So your support is based on the understanding that that is how it will operate?

Mr Harnisch—Yes, it is. Once again, to give effect to the fact that it is temporary, we would recommend that a sunset clause be attached to the bill. That is not to say that ABIP should therefore finish at the end of that particular period but that there be a parliamentary review to see its effectiveness. We have suggested that three years may be an appropriate time for a review.

Senator BUSHBY—I will come to the review shortly. As I understand it from my reading of the bill, there are no constraints based on the proposed entity. Would you feel a lot more comfortable if, as I think you have suggested—

Senator CAMERON—Point of order, Chair. There is nowhere in the bill and absolutely no way the government is proposing for this organisation to have carte blanche. I call on Senator Bushby to make sure that his points are accurate.

Senator BUSHBY—This entity has a very, very broad charter—

Senator CAMERON—It is not carte blanche.

Senator BUSHBY—There are no constraints on it whatsoever, other than—

Senator CAMERON—Nonsense!

CHAIR—Senator Bushby, have you completed your questions?

Senator BUSHBY—No. I would like to know if the association would be more comfortable if the issues that they have raised were actually put in force in some legal manner prior to the bill being passed.

Mr Harnisch—In our submission we have asked that criteria be set before the entity is established so that everyone knows what the rules are.

Senator BUSHBY—I always think that that is a good idea too, but at this stage that is not the case. If this entity is out there and it is writing business with commercial property owners around the country, after three years, as you suggest, you recommended it goes to a review. Quite clearly a lot of the business that it would have written would have terms for a lot longer than three years. So would you envisage a winding down period or that it would just stop writing new business?

Mr Harnisch—The review is just that: to at least review how ABIP is operating and the need for it. I am also hopeful that in three years time the worst of the global financial crisis will be over.

Senator BUSHBY—We all hope that. Given that you are representing the Master Builders Association, I presume that one of your primary interests in supporting a measure such as this is to ensure that there is a continuation of healthy activity in the building industry. A previous witness talked about the need for this in terms of propping up, effectively, or avoiding a collapse of the commercial market. The terms of the bill quite clearly enable the new entity to get out there and refinance the existing property market. How important is it, do you think, that the new entity focuses on new buildings?

Mr Harnisch—I note that that is not its remit at the moment. I make the point that our members for two quarters in a row are all saying to me that credit has dried up.

We see it as very important that the financial market gets restored and recapitalised. That is going to take some time. It is important that confidence is restored in the financial markets so that the normal operations can occur, but we recognise that, with the global financial crisis and the high levels of debt, money simply is not flowing as freely as it might have been in the past. So, basically, we have no problems with what is being proposed.

Senator BUSHBY—You have no problems with it. I guess with any of these measures that are proposed by government there is the question of whether you are looking for an answer or you are looking for the answer. Do you think that there are ways of addressing the issues that you see other than the specific proposal contained in this bill?

Mr Harnisch—We did make comment—and this is based on feedback we are getting from the finance sector—in terms of the mortgage funds that there has been a drying up of finance. We did ask in our submission for the government to look at reviewing as early as it can the unlimited guarantee and the effect it is having on credit flows.

Senator BUSHBY—So there are other measures that could be employed to help address the situation and there may also be alternative ways of implementing the current proposal that could still address it.

Mr Harnisch—I am sure there are many other options, but, to add to my earlier response, we are not criticising the deposit guarantee. I think it was a measure that needed to be undertaken, once again to provide confidence. History will debate whether that was a good thing or a bad thing, but it was done on balance and, if it did stabilise the market, that has to be a good thing. However, if there also have been distortions created then perhaps those distortions need to be examined.

Senator PRATT—How will we know it is working? It may be drawn on a little, it may be drawn on a lot or it may have a supporting effect without being drawn on. One of the criticisms that comes out is that, irrespective of this measure, the effect of the global financial crisis is going to continue to be felt across the construction and building industry. Irrespective of these kinds of measures, we know that the industry is going to continue to suffer some pain. How do we respond to arguments in the future that it has not worked, even though we know it will have played that supporting role?

Mr Harnisch—I will make a couple of points. We would hope that very few construction companies would seek to draw down or borrow against ABIP. In terms of how you might measure the success of ABIP, obviously it is going to be very difficult, but I would have thought that some of the measures or tests that you would put against it would be the degree to which it has avoided a catastrophic collapse in the commercial building sector, the degree to which it has avoided a catastrophic and downward spiral in asset prices, the degree to which it has avoided massive unemployment in the construction industry—and, consequently, in the rest of the economy because of its multiplier effect—and, more importantly, the degree to which it has underpinned or eroded confidence in the marketplace.

CHAIR—Thank you, gentlemen, for your evidence.

Proceedings suspended from 12.15 pm to 1.20 pm

FAHOUR, Mr Ahmed, Interim Chief Executive Officer, Australian Business Investment Partnership

CHAIR—Welcome. We recommence the hearing with Mr Ahmed Fahour, the ABIP interim CEO. Do you have an opening statement you would like to make?

Mr Fahour—I would like to make a few comments, if that is okay, before we do the questions. For the record, let it be stated that I stepped down from the board of National Australia Bank on 20 February and hold no executive responsibilities. My main responsibility as the interim CEO is to prepare ABIP as effectively as possible as a contingency company in the event that it is needed. In preparing that operational plan, I am mindful of taking into consideration a number of key parameters if the Senate passes this bill. It is a backup contingency company. It has only a two-year limited lending life. Its focus will be commercial real estate. It will only lend to commercially viable projects to fill a liquidity gap if it appears. That is to be contrasted to a credit gap. It will not lend to bad assets. It will be low risk in its lending. It will not refinance any of the four major banks' own loans; so, by nature of being a shareholder, it is prohibited from being a beneficiary of these loans.

With the above in mind, my responsibility in the next little while is to focus on this operational plan, which has about five key elements which I am trying to prepare for, to ensure that ABIP meets its objectives and the parameters that I have just laid out, which I have been and will be working on. These are in no particular order. The first one is a transition plan—what should happen on days 1, 30, 60 or 90, including things such as business registration, budget administration, accommodation et cetera. The second is an operating model of how the management of ABIP will work—its IT, its infrastructure, its day-to-day governance and processes, and its risk-management systems. The third is a communication plan to all stakeholders. The fourth is a services model for ABIP, including its lending processes, pricing management, payment administration, collections, and management of funding and treasury. Finally there are financial, legal and regulatory responsibilities to ensure that it adheres to accounting policies and those tax, legal and regulatory issues.

Those are the five key areas of what I consider to be the critical elements. I am hopeful that I and some of the small number of staff that we will hopefully assemble to pull this plan together will be in such a way that it meets its objectives. Hopefully, at the end of two years, this will cease to exist and the loans will be run off. I am happy to take any questions.

CHAIR—To go back to that timing issue, because there was some previous discussion about that, you are saying that there is a two-year limited period when loans are able to be made?

Mr Fahour—Correct.

CHAIR—Could you go into how that works—is it only a two year period during which the loans are able to applied for?

Mr Fahour—Correct, then at the end of two years there will be no more and then there will be another set period in which the loans are either sold, run off or finished. This reflects the nature of the fact that this is a contingency fund, and a limited one at that, to solve liquidity instability, if it were to emerge.

CHAIR—The loans for projects will only have a limited life. You are talking about selling off loans that are not completed.

Mr Fahour—Obviously. there might be some loans that are done on the day before the two year period runs out. They will then see themselves through. There is a second period in which you allow for the loans to run off, to be sold or to be dealt with. There will be no new applications after the two year period.

CHAIR—Is there a restriction on the loan period?

Mr Fahour—Not at this stage, but by their nature commercial real estate loans are typically are around three years.

CHAIR—So the longest possible period is going to be about five years.

Mr Fahour—From a practical point of view that is the case. We will be hedging and matching our liabilities and our assets in such a way that there is no risk in terms of the duration period and the pricing will reflect that.

CHAIR—You were talking about the tasks that you would have to do if the bills pass. You were talking about the services model and the operating model. There have been questions about whether some of those aspects might not be made clear before the bills pass so that people know under what conditions loans are made and how they will be assessed. Is that possible?

Mr Fahour—As we speak, as part of that process, we are developing among the shareholders an agreement on the loan criteria. But I can assure the senators that, if we are to meet our objectives of being a low-risk lender to commercially viable projects, it will be taking into consideration the best of the risk management systems among the shareholders themselves. 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 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.

CHAIR—Why are other banks not able to be involved in this process?

Mr Fahour—We actually have not prohibited the other banks from being involved, but it would defeat the purpose to have them involved because one of the rules that we have put in place is that we will not refinance any of the shareholders' loans. If a shareholder is involved in a loan, for example, if one of the big banks was in a syndicate and there was a gap in the refinancing then that shareholder cannot be refinanced. Therefore, if you were to take other banks in, what we are actually doing is stopping them from using this facility if they were to need it. It would not be in the nation's interest, in the interest of financial stability or in a smaller or foreign bank's interest.

CHAIR—Thank you.

Senator EGGLESTON—Mr Fahour, you are widely cited as the author of the ABIP concept. Would that be a correct statement?

Mr Fahour—I am not sure that that is completely true. This has been an effort by many people.

Senator EGGLESTON—I am sure there were many contributors. Perhaps you know how this concept evolved and, if so, could you tell the committee what sequence of events brought this idea forward. What discussions were held and what commitments were made in producing this idea?

Mr Fahour—In my capacity as interim CEO, it is not for me to commentate on the past. I am sure that the good folks from Treasury will be able to give you whatever information you need about the toings and froings in terms the government processes. I was then working with one bank, which is one of the shareholders, and so therefore my knowledge is limited to what I understand that we did when I used to work for them. Because I no longer work for them, it would be inappropriate for me to give away that information.

Senator EGGLESTON—I understand. A lot of the driving impetus for this concept seemed to be a concern of a significant withdrawal of foreign banks from the commercial property sector in Australia. Is that not the case?

Mr Fahour—There was a very serious concern post the big bubble that emerged around September-October 2008, when it looked like, post the Lehman's collapse, a major financial catastrophe was unfolding in front of our eyes. One of the elements of stability that we were trying to put in place was ensuring that you had backup plans if certain market failures occurred. I keep stressing this point 'if market was to occur'. If it should occur, you do not have the luxury, as we do right now, of having lots of discussions and dialogues and debates. When a catastrophe occurs, you want to have a very clear plan that you can press the button on immediately. So, therefore, it was considered prudent to develop this contingency plan and prepare for what may occur down the track as has been speculated might occur.

Senator EGGLESTON—Of course everybody was very concerned after the collapse of Lehman Brothers. But is there much evidence of foreign banks withdrawing from Australia, or is the 'if' word the operative word in terms of that possibility?

Mr Fahour—The notion of ABIP was largely a worry if foreign banks, as one participant, withdrew. But I remind the good senators here that it is not just limited to foreign bank withdrawal. We were concerned at the time about a number of other factors, including the following: the smaller regional banks were getting smaller in the sense that some were bought and some were in some difficulty, particularly up north and also in the sense of their ability to provide refinancing. At that time, we had a complete seizure of the capital markets, which was another source of funding that had completely shut down and has remained so. What I mean by that is the securitisation market. Because of that market actually shutting down and because some of the smaller banks and the investment banks had reduced or stopped refinancing, we were worried that if, in addition to those factors, the foreign banks also started to withdraw that that would be of a sufficient size to cause a serious problem in the financial system.

Senator EGGLESTON—So you are suggesting that the basis upon which this proposal was put forward is broader than just the foreign banks withdrawing? There was a broader base?

Mr Fahour—That is correct.

Senator EGGLESTON—Because much of what we have had heard is that this concept has been predicated on the possible withdrawal of foreign banks from Australia.

Mr Fahour—That was the large part of it, but that was not the only part of it.

Senator EGGLESTON—That is very useful information. You said in your opening remarks that ABIP would only lend to commercially viable projects.

Mr Fahour—Yes.

Senator EGGLESTON—Why wouldn't the existing Australian banks or other financial institutions be interested in investing in a commercially viable project?

Mr Fahour—Therein lies the actual issue and opportunity. In a normal functioning market, that is exactly what would happen. If it is a good project and one lender cannot do it, another lender will snap it up. That is why this is a contingency liquidity fund. Firstly, the issue that this proposal is trying to solve is not occurring in a normal market; it is actually a potential failure in the market that this proposal is trying to fill on a temporary basis. Secondly, we know that the four large banks themselves are reaching or have reached in some cases some of their own capacity limits, given their own capital ratios and their own growth, because they have had to fill in a very big gap in the marketplace already. They are growing pretty fast. They were reaching some form of limitation on their own balance sheet, so it was considered helpful and useful to have something there to support them.

Senator EGGLESTON—I want to ask you another question, but before I do can you tell us for the record what this large gap was that the banks in Australia had to fill?

Mr Fahour—With the second-tier banks lending less and the amount of credit growth of some of the non-bank players having been reduced, they were taking up some of that growth opportunity. But, as they looked forward, the total amount that they could potentially fill in the commercial real estate market was something like—I do not have the exact number—$170-odd billion, of which $40-odd billion was filled by non-domestic Australian banks.

Senator EGGLESTON—That is a quarter of it—25 a per cent. Coming back to the question I was going to ask you before I asked you that one: we are told that the two countries in the world that have the strongest banking sectors and that have been almost untouched by the global financial crisis are Canada and Australia. The Australian and Canadian banking sectors are two of the strongest and soundest in the world. If it is true that we have one of the strongest and soundest banking sectors in the world, I find it curious that you feel we need this kind of legislation. I cannot see why the banking sector would not support sound commercial investments. You have said that this proposal will invest in and provide capital to viable commercial investments. I still do not see why the Australian banking sector could not do that itself.

Mr Fahour—Without wanting to repeat myself, I will make just two comments that are important here. One is that this is a contingency plan. One of the reasons I think our great country has weathered the storm so very well because it is run by responsible and very effective executives and it has a regulatory system that has protected us. In any good company with good management there is always contingency planning. I like to use the analogy that this is a bit like a backup IT system. You hate to build them. When you do build them, you want to keep them very lean and you hope to never use them. You need to build contingencies even when things are running really well, because sometimes things fail. And when things fail, you want to have the backup plan there. You want to move onto it and then you want to get off it as quickly as you can, which is as soon as the system works again. This is what this plan is. This is a backup. Part of your success is to ensure that you have always got strong backups, which you hope to God that you will never have to use.

Senator EGGLESTON—Given that all four banks will be represented on the board, do you think there are any conflicts of interest there?

Mr Fahour—They are the shareholders and their own loans cannot get refinanced. It is the best of all worlds.

Senator EGGLESTON—Given that, is there any point in them being on the board?

Mr Fahour—You do have to be there to watch over your money because it is being applied to somebody else’s loan.

Senator CAMERON—Henry Ergas has been very critical of the government’s proposal. Mr Ergas as is a adviser to the Liberal Party and an adviser to Malcolm Turnbull. He argues that by going down this path we are simply propping up bad companies, ones that are going to fail anyway. Have you got a view on that?

Mr Fahour—I stick to my earlier comment, which is that we will not be lending money to bad companies. Bad companies will fail if they do not find their own source of financing. We will only lend to good companies that are operating successfully. We do not intend to go chasing credit risk. We are trying to fill a temporary potential liquidity gap for good companies.

Senator CAMERON—So, when Mr Ergas says that it would be foolish to try and protect the balance sheets of these companies, he has not really understood the whole purpose of this fund; is that correct?

Mr Fahour—It does not seem like he has.

Senator CAMERON—He also goes on to say that the impact on jobs is a furphy. Have you been involved in any discussions about the impact on jobs? Has that been part of your remit?

Mr Fahour—No.

Senator CAMERON—Senator Bushby said that the government's proposal is laissez-faire. You have outlined five checks and balances in your opening submission. Can you just take us to those five points again, and would you agree that the operations are a laissez-faire, no-rules type of proposal?

Mr Fahour—No, I do not agree with that statement. The bill itself outlined some very clear governance arrangements that have been put in place to ensure that this is not, to use your term, a laissez-faire situation. If laissez-faire worked then we would not be having this bill. Therefore, I think the governance arrangements which are outlined in summary form are ones that clearly protect the taxpayer and at the same time put us in the strong position that, if this fund is called upon, it will only be in a difficult situation and it will be managed as prudently and as wisely as possible.

Senator CAMERON—Can I get you to comment on a statement by Mr Ergas. He says:

At the end of the day, the only sense one can make of the proposed fund is as a wealth transfer: from taxpayers to property developers, banks and the managers of the most poorly run superannuation schemes that would otherwise have had to incur reductions in asset values. If forcing taxpayers, most of whom have low incomes, to underwrite the incomes of property developers and financiers is not 'extreme capitalism', it is very difficult to know what is.

Do you understand where Mr Ergas is coming from on this? He is influential. He is advising the Liberal Party.

Mr Fahour—That is a bit of a worry then. Sorry—I did not mean that in a—

Senator CAMERON—I thought you read my mind!

Mr Fahour—Clearly he has missed a very important central tenet of this bill. Earlier on there was some misinformation, unfortunately, about what ABIP was trying to do. 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. As far as I am concerned, those are in bad shape and are dying and will die. This will not prop them up.

Senator CAMERON—Mr Fahour, as the chief executive of this proposed organisation, you have to comply with various laws of the land including the competition laws. Are you aware of any problems, in terms of competition laws, with this proposal?

Mr Fahour—For the record, I am not the chief executive of ABIP, because ABIP does not exist.

Senator CAMERON—'Proposed' if you will.

Mr Fahour—Well, I am not the chief executive. That will be a matter for the board to decide, and for me to decide if that is what I want to do post its inception. Clearly, in taking on the responsibility of chief executive, one has to obey the laws and the governance arrangements that will be in place according to the bill and according to the various laws that will be in place at the time. I can assure you that if I were chief executive I would be ensuring that we met the letter of the law.

Senator XENOPHON—Following on from Senator Cameron's question about competition laws, in fact what is proposed is that ABIP be exempt from part IV of the Trade Practices Act. That is right, isn't it?

Mr Fahour—That is correct. Senator, I know you have Brian coming in later on.

Senator XENOPHON—Mr Cassidy?

Mr Fahour—Yes.

Senator XENOPHON—He is waiting in the wings.

Mr Fahour—Is he?

Senator XENOPHON—Yes.

Mr Fahour—So I am sure you will be asking him these questions. I am not a lawyer.

Senator XENOPHON—Sure, but were you involved in the recommendations that there ought to be an exemption for ABIP with respect to some of the activities of ABIP for which it would require an exemption?

Mr Fahour—No. That is a matter for the shareholders. It is for them to answer that question.

Senator XENOPHON—In terms of fundamental questions, you have said that, as you see it, this is a contingency fund and this is something that you do not want to use. I suppose it is a bit like a back-up generator, as an example, in a sense, isn't it?

Mr Fahour—Yes.

Senator XENOPHON—But isn't it the case, though, that it will be almost a self-fulfilling prophesy that it will be relied on as a contingency fund on the basis that it might make it easier for foreign banks to pull out of projects which ABIP will finance because they know they will get a good price for their stake? So in a sense it sets a floor; it sets almost a price guarantee for an asset. A foreign bank, perversely, may have an incentive to pull out on the basis that they know that with the existence of ABIP they will have the cushioning of this financing facility.

Mr Fahour—I disagree with that notion. As a matter of fact, I think it is the opposite. 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 in what you have said is that any one loan would precipitate a complete withdrawal of a foreign bank. I am not sure if you were insinuating—

Senator XENOPHON—No, I wasn't.

Mr Fahour—Okay. I think it would be not correct to say that just because they can get out of one loan—for example, a loan at the end of its life that has come to maturity—they have a legal right to not renew that as the loan is up. But, 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.

Senator XENOPHON—The reason I asked is that Mr Verwer of the Property Council of Australia was giving evidence earlier today and this question was put to him. I am sure he will kick up a fuss if I misquote him. He said words to the effect that this issue of whether it would make it easier for foreign banks to pull out is a moral hazard, that it is one of the issues that need to be resolved and that there is a question mark around it. I am not saying that the Property Council necessarily agrees with that, but they acknowledge that it is an initial concern. Do I take it that you do not share that concern?

Mr Fahour—No, I do not share that concern at all. As a matter of fact, Senator, as I indicated to you, I think it reinforces the message globally that Australia is a stable, strong country that provides liquidity. That does not necessarily mean, by the way, that if a loan went to ABIP as a lender of last recourse it would be at a price that does not cause some pain to the foreign bank. We will be ensuring that we get a commercially attractive return and, as the information that has been supplied to you also suggests, we will be asking for a small premium on the loans themselves to ensure that it is not an easy form of access.

Senator XENOPHON—I have one final question in this line of questioning. You cannot foresee a situation where a foreign bank, knowing that ABIP is in place, is a bit nervous about the market, is worried about declining property values, knows that if it pulls out it will have the benefit of ABIP being set up so that that will consolidate or maintain the value of that asset? You do not see that occurring under any circumstances?

Mr Fahour—No, because I know how foreign banks think. I can assure you that, whether ABIP is there or not, they will take the course of action to maximise their own home country's economics. They will not make a decision such as 'ABIP is there. Here's a way for us to push this up.' The economics is what stacks up for them, and they will make their own decisions. By the way, we are focusing on the foreign banks here. We have to remember that there are other entities in the syndicated loans that are causing even more market failure than the foreign banks at the moment—the capital markets themselves. There are no securitisation avenues available. The smaller regional banks and the nonbanks are as strong as they used to be. A foreign bank wants to make money, and if a commercially viable project is making money for them they will not want to leave it in haste just because there is an alternative. It will be because of a bigger strategic decision which has nothing to do with ABIP.

Senator XENOPHON—On the issue of commercial viability, as I understand it the criteria for what is a commercially viable loan for ABIP are still being considered or being drawn up.

Mr Fahour—We are working on it as we speak. It is one of the five modules I mentioned to you. I gave you some information that I hope will put your mind at ease. Being a banker myself—or an ex-banker, I guess—

Senator XENOPHON—Once a bank always a banker!

Senator EGGLESTON—That is what they say.

Mr Fahour—That is what my wife says as well. But as a banker you are really, really concerned about the loan criteria and the risk management. ABIP has, and the taxpayer has, a luxurious position in this public-private partnership. As Senator Eggleston said, with the four most successful banks in the world we have the benefit of being able to get the best risk management knowledge for the benefit of ABIP and all the taxpayers to protect their money. The criteria will include very stringent criteria. I am not going to put my name to any dud loans.

Senator XENOPHON—But in terms of structurally, will these criteria be set out and be available before the Senate votes on this legislation? What is your understanding of the timetable?

Mr Fahour—I think that is for the politicians to set out.

Senator XENOPHON—But you can understand why some of us will want to get a pretty good idea of what the criteria will be before a decision is made.

Mr Fahour—Right. I have given you some elements of the criteria. I have not given you the commercially confidential information, but the key elements of the kite area include loan to value ratio.

Senator XENOPHON—On that, how different will the loan to value ratio be compared to the loan to value ratio of one of the big four banks or other lending institutions? How will that vary?

Mr Fahour—It will be fairly stringent, fairly tight, and it will be only for something that could be classified as investment grade.

Senator XENOPHON—But it will not be as stringent as the existing criteria for a major bank, though, would it?

Mr Fahour—Why is that?

Senator XENOPHON—If the loan to value ratio has the same level of stringency that is currently being applied—

Mr Fahour—For an investment-grade property.

Senator XENOPHON—for an investment-grade property, why go to ABIP if you can get a loan on the same LVR with one of the existing banks? Or am I missing something?

Mr Fahour—That is exactly the point. We are hoping you will not go to ABIP. We are hoping that you will go to an existing player. The only reason that ABIP is doing it is because either the four banks have run out of capacity or there is a market failure. That is exactly the point, Senator.

Senator XENOPHON—But isn't it the case that with the loan to value ratio, and I have heard complaints from property developers saying, 'Look, it is much tighter now—

Mr Fahour—Correct.

Senator XENOPHON—'You have put it at 80 per cent of pre-sales compared with 60 per cent.

Mr Fahour—And we are going to have them give us an up-to-date market value.

Senator XENOPHON—Sure. But surely does it not follow that you could see foresee circumstances where ABIP would have different LVR criteria compared to the major banks?

Mr Fahour—Probably stricter.

Senator XENOPHON—How would that work? How would it be stricter?

Mr Fahour—Because when a commercial bank does a loan it has other sources of revenue and other sources of benefits and long relationships to take into consideration. So they may actually price and offer deals as a package to a customer that are potentially more attractive than coming to ABIP. ABIP is going to be slightly less attractive, and what we are hoping this will do is give the existing banks all the reason to do the loans. We would prefer that they do the loans. As a matter of fact, success is the system works and we do not do a single loan.

Senator XENOPHON—So your measure of success is not to do a single loan.

Mr Fahour—The system works and we do not have to use one dollar, and we have given confidence to the system and stability. That is what we really hope would happen.

Senator XENOPHON—Let us go to the shareholders agreement from Malleson Stephens Jaques. I have got a draft prepared on 11 March. I will take you to the shareholders agreement schedule 1, matters requiring unanimous shareholders' resolution. That is in one of the appendices to the document. It is quite straightforward. It says:

The matters requiring unanimous shareholders resolution are:

(a) (Lending criteria) the approval or replacement of or any amendment or alteration to the lending criteria of the company from time to time.

So the lending criteria are something that have to be a unanimous matter. I want to ask you about subparagraph (b), (Investment outside of lending criteria).

Approval of funding of any investment not otherwise permissible under the lending criteria.

My reading of that is that that means that it does foreshadow the shareholders agreement, that there may be investments outside of lending criteria that could be approved. In other words, you may not fulfil the lending criteria but there will be some circumstances where the board can decide to make a loan.

Mr Fahour—Yes. All five have to agree, with their money at risk.

Senator XENOPHON—Because it is referred to in this draft agreement, there could be circumstances where a particular loan does not fulfil any criteria but you can lend outside the lending criteria.

Mr Fahour—I think that is in any company where it is set up for a purpose and if all shareholders agreed to do something—to alter the lending criteria, for example. Any bank now has that right because of the circumstances that are in place. 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 because 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.’ We are not going to reject it, but the board may not reject it on the basis that it fulfils the objectives overall.

Senator XENOPHON—There is a concern that, if a deed of guarantee is called upon, the taxpayer bears the cost of paying for those funds to be borrowed, but, when a profit is made from the generation of ABIP, the dividends are dispersed to all members in proportion to their holdings. There is a concern, a perception, that taxpayers bear the brunt of it if things go wrong—and, of course, there is $26 billion in contingent liability.

Mr Fahour—There is clearly a misconception on this point, because clearly the $4 billion that we are talking about—the $2 billion by the taxpayer and the $2 billion by the four banks—means they equally share all losses between them fifty-fifty. It is 12½ per cent to each of the banks and 50 per cent to the government. It is fifty-fifty between the private and the public for the first $4 billion. Thereafter, if there are any loans to occur, there is a small proportion where the taxpayer bears the next lot of risks beyond the $4 billion. The Treasury folks will be here this afternoon, and I am sure they will be in a very good position to answer questions beyond that, but, from where I sit today, this is a Public Private Partnership which is fifty-fifty.

Senator XENOPHON—Which will ultimately be very successful if it does not have to make any loans.

Mr Fahour—From my point of view, that is how I see it.

Senator CAMERON—But it could also be successful if it rescues a number of projects and maintains jobs by making some loans. That could also be a success.

Mr Fahour—If there is no market failure and confidence that this is a low-cost contingency plan and the system works, that is success No. 1. If there is a liquidity failure in the system with perfectly good companies that ordinarily should get their debt rolled over, if for some reason a temporary failure in the system occurs, then the success is that it has been able to step in temporarily and deal with it until the problem passes and then hopefully fade away, like I will.

Senator FIELDING—I want to ask about your level of involvement in this proposal. I do not know what level of involvement you have had, but there is some involvement there. Where was the figure of $4 billion plucked from?

Mr Fahour—I have been involved as one among many, but I think that question is best asked of the shareholders who came to that position. What I can say to you is that it does take into consideration that there is a $160 billion lending industry out there. The existing domestic banks were approximately 130, so there is about $50 billion. We worked out the total quantum of refinancing that will occur in 2009 and 2010. Total syndicated loans were about $70 billion over those two years. Then there was a whole bunch of loan by loan build-up, which I understand Treasury looked at and worked out how much is potentially at risk and how much of that would potentially end up needing to be refinanced. A certain amount then eventuated and a decision was made between the shareholders to negotiate a certain sum. But it did take into consideration, because we and the foreign banks were at that time supplying data about the amounts that needed to be rolled over, what potential gap may emerge and how much money we need.

Senator FIELDING—Thanks for that. I will see whether Treasury can give us more of an answer on that issue.

Mr Fahour—I was hoping that would be good enough!

Senator FIELDING—On the issue of equally putting in for each of the five shareholders, why not $1 billion from each of these shareholders? You have the government and the four banks, so why not $1 billion from each of the players rather than exposing the taxpayer to that level? It just seems odd, unless someone can explain it to me.

Mr Fahour—It is a Public Private Partnership; it is joint fifty-fifty. There is a nice symmetry to that, between industry and government. I guess the alternatives are possible but I would remind you of one thing: in some ways the four big banks lose out on the big purpose of ABIP because their own loans cannot be refinanced. They do have some secondary benefits, there is no question about it. Stability in the financial system is a benefit to all. I think it is terrific that they take some responsibility for financial stability and I think by contributing $2 billion they have done the right thing.

Senator FIELDING—There is a view out there that, with this particular proposal, the Rudd government is a bit soft with the banks. You have got one shareholder putting in 50 per cent and the four banks putting in 50 per cent. It does not sound right to me. Secondly, the four banks end up picking up more market share, because it is not their own loans they are refinancing; they are refinancing someone else’s loans. You have already admitted that the loans that will be taken out will be safer because they have tighter lending restrictions than the four banks. I cannot understand why one of the four banks would not pick them up anyway—

Mr Fahour—Hopefully, they will.

Senator FIELDING—because you would not be picking them up at all. It is a safety net that is never going to be called on. If the lending criteria of the four banks are not as stringent as ABIP's, I cannot understand why one of the commercial banks would not pick it up rather than the taxpayer being exposed when they do not necessarily have to be.

Mr Fahour—Ordinarily they would pick it up, but these are not ordinary times. Secondly, if you read some of the analyst reports, the banks' balance sheets are reaching some kind of capacity limit. They cannot grow at 1½ to two times the system growth given the amounts of capital ratios and targets and industry concentration limits they have imposed upon them, which make them so safe. So what we are talking about is something that is not unusual if you think back to the late-sixties when the four banks got together and did the same thing with the resources industry. I do not know if you remember the Australian Resource Development Corporation. The four banks got together, with support, because the big resource projects were so big that they could not handle them on their own balance sheets. I am not saying that is the case study to look at, but I am giving you an example of where it is quite feasible that you reach these capacity limits and an alternative vehicle is there to deal with not-so-ordinary times. In ordinary times, I assure you, they will gobble up the market share if they can.

Senator FIELDING—The banks, I assume, would have been put these funds into loans anyway somewhere along the line, so the only extra liquidity is coming from the taxpayers—the $2 billion sitting in this fund. Isn't that correct? In other words, the half a billion dollars that the banks are each putting in would probably have gone into loans anyway, so their liquidity ratio would not have changed much. The only issue is that there is $2 billion from the taxpayers basically propping up the banks' liquidity on loans that they will pick up.

Mr Fahour—They are not picking up. Secondly—

Senator FIELDING—Come on! You cannot say they are not going to pick them up when the four banks are actually on the board.

Mr Fahour—If ABIP does the loan, by definition they have not picked them up.

Senator FIELDING—Yes, but when they are refinanced later on, it is most likely that one of the banks will pick them up.

Mr Fahour—I am not sure, but they could run off, they could be sold to the capital markets when they restore et cetera. There are all sorts of avenues available. Professional fund managers can pick them up et cetera. Secondly, the injection of this liquidity is a contingency; you hope that you do not have to use it. You know the saying—and I think you have used it before: you hope for the best and plan for the worst. That is what this says.

Senator FIELDING—The banks are on the board and they are privy to information. What information is shared between ABIP and the banks on their own commercial lending? Is there a Chinese wall put between a bank itself and its role as a board member? Knowing that they are out there commercial lending, is there information going between the two?

Mr Fahour—Again, that question is best answered by a combination of both the ACCC representative and the Treasury representative. I think it partly explains some of the legislation that is in place, some of the requirements that we are looking for, but I can assure you that all of the privacy laws have to be taken into consideration in terms of what we can and cannot do. But I would remind you that, when it is a syndicated loan, typically all the syndicate members see all the information equally and that all get the same information. So that information would be no more and no less available to ABIP.

Senator XENOPHON—You said before that the big four banks own loans cannot be refinanced—it is axiomatic. But if they are part of a syndicate and you have, for instance, a foreign bank pulling out, they will get the benefit of ABIP, won't they? They will not be precluded from being involved in that transaction when they are part of a syndicate.

Mr Fahour—Yes, where they are involved. But not only can they not have their own loans refinanced; they cannot reduce their size and position in that syndicate. There are some secondary benefits.

Senator XENOPHON—Some would say they are quite significant secondary benefits in those circumstances.

Mr Fahour—For $2 billion there should be something in it for them.

Senator XENOPHON—Sure. Finally, GE has criticised this. They say the criteria will not prevent it from going to small and medium enterprises—that the terms of the criteria could provide financing in other areas of commercial lending. The flipside of that is that small and medium businesses feel that they have a liquidity credit crunch and that they are missing out. Are you aware of GE's criticisms in relation to this?

Mr Fahour—Yes, I think I read the same newspaper article.

Senator XENOPHON—So we are aware of the same thing. How far will ABIP go in terms of assisting small and medium businesses affected in terms of their own liquidity?

Mr Fahour—This has no limitation in terms of the size of the company that is potentially going to be a recipient of the loan. So, to the extent that a small or medium enterprise is in the business of commercial real estate and they are financed by ABIP, they will benefit. So I disagree with the assertion that this is about loans to big companies, because there is nothing that stops us from going to small or medium sized enterprises. 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.

Senator BUSHBY—Senator Cameron quoted me earlier as referring to the proposal as being 'laissez-faire'. That is not the term I used. But I did actually use the term 'carte blanche' in terms of the scope under the bill for the new entity, ABIP, to decide what it involves itself in and how aggressively it goes out and seeks business. What you have told us today is that there are a number of rules that are being developed—and I apologise for missing the first part of your opening statement; I may well be covering some ground you have already gone over-and that there are rules already developed which place some additional parameters around how ABIP will approach what it does over and above what is in the bill. Is that correct?

Mr Fahour—That is correct. I stress unequivocally to Senator Cameron and the other senators that it is really critical that this be seen as a contingency company that is highly conditional, not an easy lender and there as a back-up—and, we would hope, a very short-term back-up.

Senator BUSHBY—That makes some sense. Although that is suggested in the explanatory memorandum, the bill itself does not make it absolutely clear that that is all it can do. I have some comfort in the fact that you have developed rules. Are those rules fully developed?

Mr Fahour—No. Some of the macro-governance factors that have been developed are outlined in the shareholders agreement. We are in the process of finalising what I would call day-to-day governance. For example, if I were the chief executive of this entity, we would be ensuring that this thing is not out there trying to compete with other banks and hawking its wares. It is there as a very important part of contingency. Credit criteria are being developed to ensure all the important aspects of serviceability, market value and loan-to-value ratios. For example, we want up-to-date market values of the real estate concerned so that we are not using artificial, old valuations. We are not in the business of propping up real estate prices. Bad assets are bad assets and we will not be the ones financing them.

Senator BUSHBY—I understand all of that. You said a lot of that in evidence earlier today and it made a lot of sense. I am coming back to the rules though. They are not completed. What status will the rules have? Will they be peculiar to the entity itself and set up by the shareholders? Will they be put up as regulations that go through parliament? What level of enforceability will they have?

Mr Fahour—They 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.

Senator BUSHBY—You have challenges in setting them and getting them agreed in the first place, and you have rightly pointed out that it would be very difficult to change them. But 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.

Senator BUSHBY—I will do that. Moving on, then, you talk about this being a contingent liquidity fund, and I think you made the statement that if ABIP does the loan then by definition the big banks have not done the loan. What will be in the rules to ensure that that is in fact the case? Will there be a requirement that applications must have been rejected by all other avenues before you can accept the application? How would you actually deal with that and make sure of that?

Mr Fahour—Yes, we will be requesting certain information to ensure that we can satisfy ourselves that the borrower has come to us as a lender of last recourse.

Senator BUSHBY—And that will be quite clear in the rules so that a senator could look at that and see quite clearly that it is the case that there is no opportunity for people to come to you first?

Mr Fahour—Yes, that will be in our management guidelines and governance very clearly.

Senator BUSHBY—In terms of the general overall issue that we are trying to deal with here, are you aware that three of India's largest state owned banks have made an approach to APRA to set up operations here?

Mr Fahour—I think you and I must have read the same paper this morning over breakfast.

Senator BUSHBY—Yes. There is also speculation that there will be some Chinese banks coming. Does that suggest that there is likely to be an improvement in liquidity in terms of the funds available to Australian businesses, if we have other banks?

Mr Fahour—I do not know, but I think it reinforces and supports my earlier assertion to Senator Eggleston around the fact that one of the attractions of Australia is its financial stability and its liquidity profile. There is nothing more important to a financial institution than stability and liquidity. The more we do to strengthen stability and liquidity in our system, the more likely it is, as we hope, that we will never need an ABIP and that we can attract other foreign participants to inject further liquidity into our system.

Senator BUSHBY—But even without ABIP we are getting foreign participants coming as it is.

Mr Fahour—I have been told that you should read the paper with a little bit of scepticism.

Senator BUSHBY—I would be interested to hear about it.

Senator CAMERON—Is it the *Australian*?

Senator BUSHBY—They are saying that they have made an approach to APRA, so I guess that is fairly easy to check.

Mr Fahour—Again, I think it is a wonderful tick to our country—

Senator BUSHBY—I do not argue with that.

Mr Fahour—and the more the merrier.

Senator BUSHBY—This is my last question. On ABIP itself, what staffing levels would you envisage as necessary to operate it?

Mr Fahour—Again, I know you have apologised for missing the introduction where I outlined a few of the broad parameters but, in summary, this is a temporary company to have a life of two years and then a run-down period. It is also a contingency entity, and therefore I can assure you the shareholders all want it to be very, very low cost and highly flexible. We will be looking to minimise the number of staff that it has.

Senator BUSHBY—It will probably use a lot of consultants and advisers to assist.

Mr Fahour—Not so much consultants and advisers but more secondees and also third-party entities who could do some of the operational activities. But we will also look to see what other entities there are in the government's arsenal so that we could not duplicate activities but look to minimise costs and avoid duplication.

Senator BUSHBY—So essentially you will look to the shareholders for assistance and advice where possible.

Mr Fahour—As much as possible, but their responsibility will be to ABIP. There will be some full-time staff, because they need to be independent of the shareholders to ensure that the advice and the recommendations to the board are completely in the interests of ABIP.

Senator EGGLESTON—I am interested in other bodies that provide finance for property trusts. I just wondered whether the bank guarantee which you will be providing has distorted or might distort the ability of property trusts to raise finance for commercial property developments. What do you think?

Mr Fahour—I am sorry, Senator. What guarantee am I giving?

Senator EGGLESTON—The guarantee of last year, the previous bank guarantee. The federal government has undertaken to guarantee the bank deposits—

Mr Fahour—I am not the chief marketing officer of the government guarantee. I am the interim chief executive of ABIP.

CHAIR—I think Treasury perhaps might—

Senator EGGLESTON—What about just in general terms? Is the existence of this body you are setting up going to cause distortions within the property financing market within Australia?

Mr Fahour—I think you will find the property trust industry will be pretty relieved if you guys are good enough to pass this through. This should be a major benefit to them, if they need it. I think anything that—

Senator EGGLESTON—There is that ‘if’ word again. It has cropped up an awful lot in this discussion.

Mr Fahour—I think if you read the Property Council’s submission you will see—and you might have just glanced over this—one particular page which highlights, for example, the listed REIT market, which is a lot of the property trusts we are talking about. You would see in there that 70 per cent of listed REIT loans come from foreign banks. They are quite nervous now. They have already copped quite a bit and anything that can restore some confidence and some relief would be a good thing for them, I would have thought.

Senator EGGLESTON—But, again, the ‘if’ word comes in—‘if they withdraw’. They have not yet, have they?

Mr Fahour—That is what a contingency plan is all about.

CHAIR—Thank you, Mr Fahour, for staying on so long and giving evidence so comprehensively.

Mr Fahour—Thank you very much.

[2.27 pm]

CASSIDY, Mr Brian, Chief Executive Officer, Australian Competition and Consumer Commission

GREGSON, Mr Scott, General Manager, Co-ordination Branch, Enforcement and Compliance Division, Australian Competition and Consumer Commission

CHAIR—Welcome. Thank you for coming in this afternoon. Do you have an opening statement you would like to make?

Mr Cassidy—I was not proposing to make an opening statement other than perhaps to make the observation that our involvement with ABIP has been very much on the margins around one particular issue. I think that rather than any opening statements it is probably better if we just take any questions the committee might have.

CHAIR—Thank you. One important issue that we have is that a number of questions were put you in relation to the Australian Business Investment Partnership in the recent round of Senate estimates and some of those questions were taken on notice by Treasury officials and the ACCC. Do you have any answers to those questions?

Mr Cassidy—We are still discussing that issue with Treasury. I think basically the main issue that was taken on notice was whether we could provide the committee with an exchange of emails that occurred between Treasury and ourselves. I think we indicated at the time that an email from Treasury included certain details which were then proposed in relation to what is now the proposed partnership and our response was a fairly broad brush, general one, particularly on section 45 of the Trade Practices Act. We are still discussing with Treasury the possible provision of those emails to the committee. We feel obliged to do that because, as I say, one of them actually originated from Treasury. From my point of view, there are sensitivities in the emails. The sensitivities would be, I suspect, in the email from Treasury to us rather than the email from us to Treasury.

CHAIR—Are you saying we should ask Treasury for more about this?

Mr Cassidy—Obviously you can ask Treasury, but at the moment we are still in discussion with Treasury about just what we can do about providing those emails to the committee.

CHAIR—From your point of view, when could we expect those answers? Will it be before we are due to report on this?

Mr Cassidy—When are you due to report, if you do not mind me asking?

CHAIR—The 10th.

Mr Cassidy—Strictly speaking, the answers to the questions we took on notice at Senate estimates were due by this Friday.

CHAIR—I think they were due today.

Mr Cassidy—Sorry. My advice was Friday. Put it this way: I have my eye on Friday as when we want to get our answers to you.

CHAIR—Okay.

Senator EGGLESTON—Can the ACCC outline whether it feels the presence of ABIP in the market will help competition in the commercial property sector?

Mr Cassidy—I suppose my answer to the would be along the lines of the answers you were getting from Mr Fahour earlier. To the extent that the partnership is a proposed safety net mechanism, if you like, and only comes into play if there is a failure in the market, from that point of view we think it does have the potential to facilitate competition in the market. I suppose on the other side of the coin—and there are pluses and minuses—to the extent that the existence of the partnership and the possibility of information being passed back from the partnership to the individual banks involved may potentially reduce competition in the market, where you would come out on balance on that I think would be a difficult question to answer. There are pluses and minuses potentially.

Senator EGGLESTON—Sounds like it. I would have thought in relation to the first bit that it preserves the status quo in the market, because you are maintaining the property development without necessarily enhancing or bringing in other players. But there we are. Also, the ABIP proposal has been criticised by some people as a government sponsored cartel. Does the ACCC believe the specification of actions undertaken by ABIP or ABIP designated persons under section 51 of the Trade Practices Act is warranted?

Mr Cassidy—It is a difficult question to answer. The detail that we have seen in relation to ABIP and the way that it will operate still does not allow us to get to a concluded view on whether, leaving aside the proposed exemption, it would be a breach of section 45 of the Trade Practices Act or not. The reason for that is that in section 45 there is a so-called joint venture defence. Without going into the detail, what that basically says is that if companies that would otherwise be competitors enter into a joint venture, contribute to a joint venture and do things in pursuit of a joint venture then they do not run afoul of section 45 unless those activities result in a substantial lessening of competition. That means that in order to get to a concluded view we would need to have more detail than we have at the moment on exactly how ABIP is going to work, including the ring-fencing arrangements in the shareholders agreement for the passing back of information to the individual member banks. We would also need to make an assessment of whether those activities were likely to result in a substantial lessening of competition in the market, which in a sense goes to your first question. And we would probably need some external legal advice in the course of all that.

We have not undertaken that assessment because, as you would be aware, the bill proposes that there be an exemption in the Trade Practices Act for ABIP. That would be a hypothetical exercise for us, which we have just not undertaken. I cannot give you a definitive answer on whether, absent the proposed exemption, the activities of ABIP would run foul of the Trade Practices Act, and section 45 in particular, or not.

Senator EGGLESTON—Exemption seems a rather unusual step to take, don’t you think? It means, surely, that there is less protection for the Australian consumer.

Mr Cassidy—Section 51 exemptions are certainly not all that common, particularly at the Commonwealth level. I think there are about 70 exemptions in existence at the moment, and the bulk of those would be from one or other of the state governments’ particular activities. So, yes, there are not all that many Commonwealth section 51 exemptions. In that sense it is an unusual arrangement.

Senator EGGLESTON—Some commentators say that section 16 of the bill would allow ABIP to operate as a cartel. Was section 16 written with the advice of the ACCC to Treasury and to the government? If so, could you table that advice.

Mr Cassidy—Let me briefly recount what the Chair was referring to earlier in terms of the questions asked at our last Senate estimates appearance, where Senator Brandis was asking us about our involvement in providing advice to Treasury on ABIP. We indicated that the advice that we provided was very broad brushed and high-level in nature—basically an explanation of section 45 of the act, which relates to anticompetitive agreements. We pointed out that to the extent that the proposed bank representatives on the board of ABIP were, if you like, fully ring-fenced from the banks at which they were employed you would have fewer concerns about the possibility of information being passed between ABIP and its member banks. You could then see ABIP being, in some sense, used as a mechanism whereby agreements could be reached between the banks or their representatives. That would be more of a concern. It was fairly broad brushed stuff.

We also referred to the mechanisms for dealing with possible problems, the first one being the authorisation process under the act and the second one being the section 51 exemption mechanism. But that was the total of our discussions with Treasury. We never got down to the detail of Treasury saying to us, ‘What if ABIP was to do this? Would that be a problem?’ Indeed, Senator Brandis was pointing out in his questioning that there is an issue for us as to how far we can go in providing that sort of detailed advice anyway. 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.

Senator EGGLESTON—No. We have got that message. But there is a bill before the parliament now which would criminalise cartel activity. That must raise concerns if proposed section 16 condones, in effect, the creation of a cartel, wouldn’t you think? And that might be of interest to you.

Mr Cassidy—My answer to that would be a conditional yes in the sense that there are a couple of ifs in your question—

Senator EGGLESTON—'If' has got a good run today, I must say!

Mr Cassidy—Yes. It is a word that is bit like that. But as I said earlier—of course, it would be purely a hypothetical exercise—we have not, certainly not in our own minds, reached a position of saying: were it not for the proposed exemption from section 51, then what is proposed would be a breach of the law regarding cartels. It would require a fair amount of work on our part to get to that position.

Senator EGGLESTON—Another 'if' situation is that 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.

Senator EGGLESTON—It is possible of course that ABIP could apply to you for exemptions from the cartel provisions of the Trade Practices Act. If they did so, what additional factors might you seek in clause 16 to agree to such an exemption?

Mr Cassidy—Besides the exemption provisions under section 51 of the Trade Practices Act, the other mechanism for providing a shelter for conduct is what we call the authorisation process. Under the authorisation process you would not have a section like proposed section 16. What would happen is that ABIP would come to us and make an authorisation application, and in that application they would say: 'We're proposing to undertake certain types of conduct; that conduct could be in breach of the act. However, on the other hand, we believe there are these various benefits that would come from the conduct.' We would then need to weigh up the possible anticompetitive effects against the other claimed benefits—and they can be benefits of any kind—and if we think that the benefits outweigh any anticompetitive effects then we can authorise the conduct, which means it is then protected from action being taken under the act. So that is the other route. That does not, as I say, involve any other provision being made in the bill itself; it is just a process which is provided for under the Trade Practices Act.

Senator EGGLESTON—That is very general answer, but there we are. You are not dealing with specifics, I suppose. You will probably feel that you have answered this already, but has the ACCC been provided with any information about the details of the ABIP proposal since the Senate additional estimates round in February; and, if so, has any of that information raised any concerns at the ACCC about the treatment of ABIP under the Trade Practices Act?

Mr Cassidy—The only information we have obtained in relation to ABIP since we appeared at additional estimates in February is information which has come into the public arena. We have not been provided with any separate information by Treasury.

Senator EGGLESTON—So you have not been asked for specific advice?

Mr Cassidy—No, we have not. As we indicated in February, we had some exchanges with Treasury both before and after Christmas, but really we have not had an exchange with Treasury on ABIP since those exchanges occurred in December-January.

Senator EGGLESTON—Thank you.

Senator XENOPHON—Can I clarify this, Mr Cassidy. The exemptions are clearly set out and are comprehensive in terms of this legislative framework, but whether ABIP operations would lessen competition may not be known until the further criteria and day-to-day governance details are known. Is that a fair summary?

Mr Cassidy—Indeed. If for some reason we were to undertake what I referred to with Senator Eggleston as the hypothetical inquiry, we would need to know more about exactly how the entity was going to operate on a day-to-day basis, what the relationship was going to be between the members of the board—particularly the bank members of the board—and the banks from which they come and so forth.

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’.

Mr Cassidy—That is right. It is a known unknown.

Senator XENOPHON—On this whole issue of ring fencing and Chinese walls, we will not know what information is shared until those arrangements are in place. 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, anticompetitiveness 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.

Senator XENOPHON—Can I take issue with that? I mean not so much that I want to take issue in an adversarial sense. Could I just get some clarification from you on that? Would it be fair to say that, if the ACCC had a role in monitoring the impact of the exemptions on consumers, the ACCC could have a valuable role in advising government as to what those impacts would be so government could then make a decision as to whether it would need to either tighten or modify the exemption in any way? The ACCC would be in the best position of any organisation to determine how consumers could be impacted on by these exemptions.

Mr Cassidy—Possibly. I should explain that, particularly with section 51 exemptions by state governments, there is a mechanism whereby the Commonwealth government has an override power so far as state government exemptions are concerned. They can seek advice from the National Competition Council in relation to any new section 51 exemptions that are put in place by state governments. Whether the ACCC or the NCC is the best placed body to do that is probably something you could speculate on. It would be one or other of us if there were to be that sort of role.

Senator XENOPHON—Finally, I refer to the front page of today's *Financial Review*. Your chair features in the front page lead. I do not know if you have seen that story. It is headed 'Samuel warns on bank mergers'. Are you familiar with that?

Mr Cassidy—Yes. I read that while I was trying to get on one of my cancelled flights this morning.

Senator XENOPHON—By the sounds of it, you would have had time to read it three or four times!

Mr Cassidy—I could have, yes.

Senator CAMERON—He went to the sport right away!

Senator XENOPHON—There is not much sport in the *Financial Review*.

Mr Cassidy—I had Senator Conroy sitting alongside of me, and he drew my attention to another article in the press this morning. You can probably readily discern what that one was.

Senator XENOPHON—Mr Samuel has been critical, I think it is fair to say. In his comments, he says:

> The risk is with four big banks, because of the diminished role of non-bank financial institutions, we end up with less than intense workable competition.

That means it is easier for the big banks to conduct their business with perfectly legal asset coordination of pricing. Has the ACCC considered what the impact of ABIP might be in the context of the concerns that your chairman has outlined about a lessening of competition or 'less than intense workable competition' in terms of that? Could ABIP have the potential to exacerbate the trend that Mr Samuel has drawn attention to?

Mr Cassidy—As I think I answered to Senator Eggleston, you can think of arguments that go both ways in relation to that—on the one hand, in terms of it being procompetitive if it does help avoid a collapse in the commercial property market; on the other hand, it could be quite anticompetitive depending on the clutch of issues that we have been talking about, the known unknowns.

Senator XENOPHON—It depends whether you are a buyer or a seller.

Mr Cassidy—So I am afraid we do not know quite what the answer is on that question.

Senator XENOPHON—Okay. Thank you.

Senator BUSHBY—Thank you, Mr Cassidy. It is good to have you here and to hear what the ACCC's views are on this. 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.

Senator BUSHBY—That is a very good question, which I imagine has vexed some of us, particularly since the lack of information about how the bill will actually operate as an act makes it very difficult for us to obtain informed advice from organisations such as yours as to what impact that would have without that particular clause. You mention that you have had email exchanges with Treasury and that there are still some discussions happening regarding whether those would be made available or not. Without disclosing the sensitive material, can you disclose the nature of those exchanges?

Mr Cassidy—The Treasury basically sent us an email which contained some details of how it was proposed that ABIP would operate. Bear in mind that this is going back to, I think, early January. Obviously you could speak to Treasury about this, but I think it would be fair enough to say that they regard those details as still being of a certain degree of sensitivity.

We, in response, provided what I have called some fairly high-level advice in terms of both the relevant sections of the Trade Practices Act and the various provisions whereby conduct can be taken outside the act, and that is the authorisation process and the section 51 exemption mechanism. The reason that advice from us was fairly high level was because, even though the email from Treasury contained a certain amount of detail on how it was proposed ABIP would work, it still did not contain sufficient detail from our point of view to be able to be in any way definitive about what any particular issues might be so far as the Trade Practices Act was concerned, hence our fairly general, broad brush advice that was contained in our email back to Treasury.

Senator BUSHBY—Do you think the high-level, broad brush advice that you gave them may be why they did not come back to you after that and just proceeded without any further exchanges?

Mr Cassidy—To be honest, we were dealing with people in Treasury who probably know the Trade Practices Act almost as well as we do. Given that they are the policy department, it was really up to them as to whether they felt they needed to consult us further. As Senator Brandis pointed out in the February additional estimates hearings, there are some constraints on us as the regulator and law enforcer in terms of how far we can go down the path of providing advice to people on the law and how it applies. At the end of the day, people have to take their own advice and their own view on that and then we, as an independent regulator, see whether we end up taking the same view or not. So the fact that Treasury did not come back to us I do not think we regarded as surprising in any way—and, in line with Senator Brandis's questions, you might almost say that is the appropriate way of this going forward.

Senator BUSHBY—Okay. On clause 16, as contained in the bill now: you mentioned that you had no input into that clause. Have you had a good look at it since the bill was released?

Mr Cassidy—Yes, we have had a look at it.

Senator BUSHBY—Are you confident that that would relieve—I think you hinted at this earlier—any further interest that you might have in the activities of ABIP in terms of most potential breaches of anything in the Trade Practices Act?

Mr Cassidy—On its face, it seems to us to comply with the requirements of section 51 of the Trade Practices Act, so it seems to us to be a valid exemption.

Senator BUSHBY—Would you agree that some of the activities as proposed for ABIP would actually constitute a cartel, in terms of the definition for that?

Mr Cassidy—As I was saying earlier to Senator Eggleston, the ABIP would clearly be a joint venture in terms of the Trade Practices Act, so in order to be able to get to a position of saying whether it would be a cartel we would need to establish whether it fell within the joint venture defence. That means, in particular, we would need to have more detail on its proposed operations and we would have to undertake an assessment of whether they were likely to result in a substantial lessening of competition.

Senator BUSHBY—In general, what would be the characteristics of the joint venture defence?

Mr Cassidy—In general, the characteristics are that companies that would otherwise be competitors get together to form a joint venture for the purpose of undertaking particular activities, and each of the joint venture parties contributes something to the joint venture, be that finance, be that intellectual capital, whatever it might be.

Senator BUSHBY—More importantly, what distinguishes it from a cartel? What actually puts it outside of that?

Mr Cassidy—As I say, if they are getting together to undertake an activity as specified in the joint venture agreement and if in undertaking that activity they are not substantially lessening competition—

Senator BUSHBY—Is that the distinguishing factor: they are not to substantially lessen competition?

Mr Cassidy—In terms of the act, the substantial lessening of competition is an important requirement for the joint venture defence.

Senator BUSHBY—The joint venture defence would not be available if there were a substantial lessening of competition as a result?

Mr Cassidy—That is correct. The way the joint venture defence operates is if the activities did result in a substantial lessening of competition then the joint venture defence would not apply.

CHAIR—Senator Bushy, do you have any more questions?

Senator BUSHBY—No.

Senator XENOPHON—Just going back to the issue of exemptions, do you think there would be any value or a need for a competition and consumer impact study before granting section 51 exemptions in the first place?

Senator BUSHBY—That is a good question.

Mr Cassidy—Do you mean as a general proposition in relation to section 51 exemptions?

Senator XENOPHON—Yes.

Mr Cassidy—The Commonwealth, in a sense, cannot police the Commonwealth—

Senator XENOPHON—At a federal level?

Mr Cassidy—Certainly, so far as the state governments are concerned, that is a mechanism that exists. If they do put in place a section 51 exemption and the NCC, at the request of the Commonwealth, looks at it and says, ‘No, that will have a significant detrimental effect’—

Senator XENOPHON—I am not clear. Should that be happening here, though?

Mr Cassidy—I think you are getting into a policy issue there. It comes out of the national competition policy arrangements of the mid-nineties. Those are not the arrangements as they are at the moment. It is really a policy issue which I do not believe either of us can answer.

CHAIR—Thank you, Mr Cassidy and Mr Gregson for coming in this afternoon. The questions on notice answers are due on Friday, 17 April.

Mr Cassidy—We will do our best to have them by Friday. We will have a five-minute break and then come back with AMP.

[3.07 pm]

COOKE, Mr Trevor, COO/Senior Investment Adviser, AMP Capital Investors Ltd

GREEN, Mr Benjamin John, Portfolio Manager, Debt Advisory, AMP Capital Investors Ltd

JUDD, Mr Christopher James, Head, Property Funds Management, AMP Capital Investors Ltd

CHAIR—Welcome. Do you have an opening statement you would like to make?

Mr Cooke—I would like to thank you all for giving us this opportunity to speak to you today. In the first instance I would appreciate the opportunity to read into *Hansard* an opening statement. I would then ask that the committee consider allowing us to move into in camera. As you appreciate, we are players in the commercial marketplace and have access to information which is commercially sensitive but, in the spirit of giving the committee as much information as we can, we think the best way to accomplish that is to move in camera after an opening statement. I would ask that the committee consider that request.

CHAIR—That is fine. If you could read your opening statement then the committee will take a vote on going in camera.

Mr Cooke—I will just briefly cover AMP Capital and why we are here today, where our interests lie and what our position is in relation to commercial real estate markets. I will briefly touch upon what we see as the critical factors in the global financial crisis that have an impact on this sector in Australia and then give you some of our thoughts on how we think ABIP could potentially operate, with perhaps some enhancement to the current proposals.

You are probably aware that AMP is one of Australia’s largest and most established managers of commercial real estate. We manage a $15 billion portfolio of Australian commercial real estate on behalf of our investors. The owners of those assets are really working Australians who choose AMP as their superannuation fund manager. We have a group of direct investors in one of our many property funds, other Australian superannuation funds and other institutions which invest in one of our pooled funds or separately managed accounts. All up, we have several million Australian customers invested in that $15 billion commercial property portfolio.

The assets we manage include some of Australia’s pre-eminent commercial offices, shopping centres, industrial and business parks. Our investment philosophy is simple. We enable small investors to gain access to these large-scale commercial properties which they would not otherwise have access to. Our funds are very transparent and simple. Investment returns are tied directly to the assets and not otherwise financially engineered. Our assets typically have very low gearing or in some cases none at all. For example, AMP’s flagship $5 billion core property fund was established in 1971 and has no underlying gearing.

With respect to the global financial crisis and commercial real estate, failure in the financial system itself is a root cause of the global financial crisis—that is, it is a systemic issue. This systemic failure affects investors across all tiers of the commercial real estate capital structure. It does not discriminate between debt or equity, foreign or domestic interests. Debt generally remains unaffordable if it is available at all. The spreads between BBSW and refinancing rates are at all-time highs. In certain circumstances the price of debt may make the arrangement unaffordable or detrimental to the interests of investors. In many cases, lenders simply refuse to renew financing arrangements. One obvious choice would be to seek to replace the debt with equity; however equity is equally scarce.

Liquidity is being drained out of the sector by investors who themselves are now facing cashflow and other issues. In some cases, managers have had to deny their investors access to their own capital in order to avoid the further erosion of wealth for remaining investors. In the end, the people being hurt most by the global financial crisis are ordinary working Australians whose savings, be it in superannuation or other savings vehicles, are being destroyed by circumstances beyond their control.

AMP Capital Investors believe that the government should be encouraged to establish ABIP as a liquidity facility for the commercial property sector. A core objective of the fund should be to mitigate wealth destruction for ordinary Australians. To meet this objective the current bill should be amended. Section 7 of the act should be extended to place all investors in commercial real estate on a level playing field or at least afforded the same level of protection. In our view there is no public policy interest in affording special treatment to investors whose manager has arranged debt finance via a syndicate involving a foreign bank while investors in another property fund do not receive similar treatment.

The objective could be accomplished by amending section 7(1) of the bill so it reads, ‘The object of ABIP Ltd is to enter into financial arrangements relating to commercial property assets in Australia in situations where finance relating to the assets is not available on commercial terms and the assets are otherwise financially viable.’ This change would of course necessitate other consequential amendments to the bill. One alternative would be for support for the narrower mandate of ABIP as currently set out in the objectives section applying to the initial $4 billion in shareholder capital so as to preserve the alignment of interest between the contributor of the capital and the beneficiaries. After that though, capital raised by ABIP via Australian government bonds should be used for the broader objective of preserving wealth for all Australians. We believe this provides better alignment between the funding and funded parties.

The tools at ABIP’s disposal to achieve its objectives should be flexible so as not to limit its effectiveness. ABIP should therefore be able to enter into any type of financial arrangement to meet its objectives. Importantly, we believe that these objectives and therefore the financial arrangement would be restricted by the requirement of the assets which are the subject of the financial arrangement are otherwise financially viable.

We also believe that the committee should recommend that government better delineate the tests of commercial and financial viability for transactions to be funded by ABIP. Criteria consistent with those of major domestic banks are perhaps not appropriate where the criteria are driven by the commercial interests of the major banks and finally better delineate the process by which four banks and the government will make decisions on transactions selected for funding. Thank you.

CHAIR—With the agreement of the committee, we will ask people who are not members of the committee to leave the room and we will go in camera.

Evidence was then taken in camera—

[3.56 pm]

ERGAS, Mr Henry, Chairman, Concept Economics

Evidence was taken via teleconference—

CHAIR—Welcome, Mr Ergas. Do you have an opening statement you would like to make?

Mr Ergas—Yes, if I could. I have prepared a submission, and provided it to the committee, which sets out in detail the empirical material relevant to assessing the proposed Australian Business Investment Partnership. Without wanting to summarise that submission, its conclusion is that with its legislation for an Australian Business Investment Partnership the Australian government has set what could prove a dangerous precedent. Not only does the government intend to intervene in order to prop up prices in a narrow sector, the commercial property market, but this legislation undermines a basic cornerstone of a well-regulated market economy, that is, a consistent and transparent approach to competition policy.

There are a number of problems with the bill. There seems to be little convincing evidence justifying the primary rationale for the proposal, assisting 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. Indeed, in its most recent statement on monetary policy the Reserve Bank noted:

> 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 businesses. While there is a risk that some foreign lenders will scale back their Australian operations, 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.

The legislation could potentially create moral hazard problems and precipitate the very events it is designed to forestall. The legislation also potentially creates a situation where the shareholders of the four major banks are faced with conflicts of interest over their role as members of ABIP on the one hand and their separate commercial interests outside of this company on the other.

Finally, the legislation sets a poor precedent for the application of competition policy principles. The exemption of the new entity from the key competition provisions of the Trade Practices Act is particularly disappointing given the government's commendable decision last year to abolish the Australian Wheat Board's statutory export monopoly and introduce competitive forces into that market. The exemption that has been given the new entity from those provisions of the Trade Practices Act is also inconsistent with the competition principles agreement. On this occasion there has been no attempt to justify why what would otherwise be held to constitute price-fixing or cartel behaviour, which the government says should be subject to criminal sanction, including imprisonment, is so desirable and indeed so urgently necessary in this instance but is inimical to economic welfare in most other situations. It is relevant that the Trade Practices Act provides for the ACCC, following a public and transparent process, to authorise conduct that might breach the Trade Practices Act competition provisions so long as it is known that the public benefits from the conduct outweigh the competitive detriment. If the government believes the public benefits from its proposal outweigh the competitive detriment, it should submit the proposed conduct for ACCC authorisation.

In summary, this legislation is best characterised as lacking in transparency, accountability and prudence. I will be happy to address any questions you might have. I might say that I am accompanied here by my colleague Dr Alex Robson.

CHAIR—Thank you, Mr Ergas. You mentioned distressed syndicates and propping up prices. The evidence we have heard today is that it is not intended for distressed loans or to prop up prices but rather to give the industry confidence to stop prices plummeting, and that if this entity invests it will only be in assets that are not distressed and entities that are not distressed.

Mr Ergas—If the assets at issue are commercially viable then I believe the evidence suggests that they would be able to obtain funding from the normal sources of finance. Indeed, in its most recent financial stability review the Reserve Bank noted that where property companies had large refinancing requirements they were generally able to roll over their debt. So it is not clear to me why a new entity would need to be created for this purpose if private commercial markets which operate without taxpayer subsidy were able to do the job. Of course, if there is the added risk that by this means you induce collusion between the major banks or facilitate price-fixing, that would be positively detrimental to the proper working of commercial property markets rather than helping them.

CHAIR—In what way are we facilitating price-fixing among the banks with this legislation?

Mr Ergas—The essence of this legislation is that it provides for the major banks to the parties to this new entity, but not merely to be parties to it but to play a key role in its decision-making. As a result they would be exchanging information and expressing views that would become known to the other major banks that are their competitors. Were that conduct engaged in by the major banks themselves, were they to set up for themselves such a vehicle or entity, that conduct would probably be a per se breach of sections 45 and 47 of the Trade Practices Act.

CHAIR—But there are a number of syndicated loans commonly involving more than one of the major banks.

Mr Ergas—Indeed there are, but what is at issue here is an entity that considers investment on a case-by-case basis, assesses proposals, exchanges information about whether or not one of the members would be willing to finance it commercially and then has an exchange of views in that respect, all of which, I suggest, would likely be conduct in breach of the Trade Practices Act were it not specifically authorised be it by a provision which is built into section 16 of this legislation or by authorisation by the ACCC or the Australian Competition Tribunal under the authorisation provisions of the TPA.

CHAIR—We have heard that none of the schemes invested in, if this bank does invest, will involve any of the major banks that are on the board—that is, it will not be any of the assets that they are involved with financing.

Mr Ergas—That is right. But, if I have understood the proposal correctly, it would pick up assets that the major banks are not interested in financing or those components of syndicated loans that they are not interested in financing. What would be presumably disclosed and potentially discussed at the management meetings of this entity would be precisely the intention of the participants with respect to the syndicated loans that are being considered for refinancing by this entity. The exchange of that information amounts to a commitment not to compete and, as such, would absent the specific provisions of section 16 of the bill and would likely require authorisation under the Trade Practices Act by the ACCC or the Competition Tribunal—as it might otherwise involve a breach of section 45A and section 47 of the Trade Practices Act.

CHAIR—I suspect we could go through details of that all day, but I might turn to Senator Cameron.

Senator CAMERON—Thank you. Dr Ergas, I note in the letter that accompanies your submission you do not mention that you are doing work for the Leader of the Opposition and the Liberal Party. Have you stopped doing that work now?

Mr Ergas—As the senator may know, I am undertaking a review of the tax system for the opposition. I do not know if that is what he means by working for the Liberal Party.

Senator CAMERON—Yes, that is what I mean.

Mr Ergas—As I have made abundantly clear on a number of occasions, I am undertaking that pro bono. If anything, the relationship is the other way around.

Senator CAMERON—Okay. This is probably the weakest argument I have heard from you on anything that you have put forward in my time on the economics committee. I must say it seems to me it is really about your ideological position that governments should not be involved in the market because they create a market-distorting intervention. Isn't that the case? It is not really about whether this is good or bad; it is about the market.

Mr Ergas—No. I am afraid, with respect, that is incorrect. My position is the following. There is a proper role for government to intervene where markets fail, and I am entirely in favour of sensible government intervention where markets fail and governments can set things right at less cost than the cost of the market failure. But what that requires and is of the essence of evidence based policy is that you point to a market failure that you are correcting. In this case, there is as well as that issue in my view the very dangerous precedent associated with exempting conduct by the major banks from the provisions of the Trade Practices Act. The Commonwealth during the Keating government entered into the competition principles agreement with the states and, as part of the competition principles agreement, accepted a number of restrictions on its ability to exempt conduct from the Trade Practices Act. Those restrictions have not been reflected in this case, and I believe that to be a cause for concern.

Senator CAMERON—With the greatest respect, Dr Ergas, I find your submissions really hard to treat seriously because I do not think they are rigorous or independent. You have made two public statements on this legislation. Those led me to have a look at the 23 articles that you have done for the *Australian*. You have been a serial critic of the government on industrial relations, on the Carbon Pollution Reduction Scheme, on the broadband network, on the car plan, on the stimulus packages. How can we take you seriously as an independent commentator?

Mr Ergas—It sounds like you have it pretty right.

Senator CAMERON—That is right.

Mr Ergas—With respect, Senator, if you have points of substance that you would like to make either about my arguments in general or about my submission—

Senator CAMERON—I am trying to get your arguments in context, you see.

Mr Ergas—I will be happy to deal with them, but an ad hominem attack is not a particularly constructive way of engaging a public policy debate, at least in my opinion.

Senator CAMERON—I am trying to get on the public record your position generally, and that is your position—you are a serial opponent of government legislation, and this is part of that process.

Mr Ergas—May I point out, Senator Cameron, with the greatest respect, that I was also a harsh critic of many aspects of the previous government. I believe it is an important part of an economist's role to help analyse and explain the key economic policy issues of the day, and I try to do that to the best of my ability. If you have specific criticisms that you would like to make of the manner in which I advance my arguments or the substance of those arguments I am obviously happy to hear them.

Senator CAMERON—As I said, I think these are some of the weakest arguments I have heard from you. They seem to be completely out of sync with businesses that have come before this committee and argued that there is a systemic failure of the financial markets affecting the property industry in Australia. I have not seen any analysis from you on this global financial crisis or whether that is part of the failure in this market.

Mr Ergas—Senator, if you look at the submission that I provided—and I apologise for the lateness of it—you will see a considerable amount of empirical evidence that goes to the point you have raised. Specifically, I cite at some length the Reserve Bank, which is a reasonably well-informed observer of the market, where it specifically comments on the questions that you raise. As best I can tell from the Reserve Bank and from the other evidence, the situation at the moment here, to use the exact words that the Reserve Bank uses in its financial stability review, is that 'most property companies ... were generally able to rollover their debt.'

Senator CAMERON—No-one else has this very optimistic view of being able to rollover their debt. I note that in their submission the Property Council quotes Glenn Stevens, the Governor of the Reserve Bank, who says:

I think [a fire sale] is probably worth avoiding. So I do not have any problem with there being a plan—

that is the ABIP—

in the top drawer ..

What do you say to that?

Mr Ergas—With respect, I have looked at that submission. I must say it does not contain a great deal of what I would regard as empirical evidence. It is very light on data. Moreover, as I said, having reviewed that data and other data, the Reserve Bank has come to a quite different conclusion. In that sense, I believe it is reasonable to conclude at this point that, as the Reserve Bank has also said in its statement on monetary policy, there is no evidence of large foreign owned banks planning to roll back their lending activities in Australia.

Senator CAMERON—But, Dr Ergas, how can we take you seriously in terms of empirical evidence when on page 11 of your submission under the heading 'Problems and unintended consequences' you open up by saying:

... bailing out distressed syndicated commercial property lenders and preventing fire sales ...

when that is not what this is about? How can we take you seriously?

Mr Ergas—To the best of my knowledge, the intention of this new entity is to refinance commercial property debt that the major banks are not willing to refinance, with the purpose of avoiding reductions in practice for commercial property. That is exactly what is summarised in the statement by me that you read out. If the intention is different from that then clearly the government should explain it better.

Senator CAMERON—Maybe that is the issue there. The business participants who have come here have all been supportive of this scheme. They do not seem to agree with your analysis, whether that is on empirical data or not. They are arguing very strongly that there is an impending crisis. In fact, some of them have argued for even more government intervention in the market to assist with this global financial crisis. So should we just let the market rip or should we intervene?

Mr Ergas—No, I do not believe that is correct. What I do believe is that the Australian experience over a period of a century is that, for better or worse, our businesses are never backward in putting up their hands for government assistance. If the government assistance is made available, then I am not surprised that potential beneficiaries of that government assistance would be supportive of it. That does not necessarily mean that their motives are poor. But what it does mean is that the crucial role of a committee such as yours is to probe carefully and in detail and with considerable rigour whether those requests for assistance—which will be funded by the taxpayers, who have not been given the option of deciding whether to fund this commercial property syndicate or that—are good value for money and are genuinely in the public interest rather than in the private interest of their immediate beneficiaries.

Senator CAMERON—With the greatest respect, I do not think your submission actually helps us to probe in the manner that you are asking us to do. If I can take you to page 13 of your submission, you ask, 'What about the impact on jobs?' and you argue:

There has been no convincing evidence put forward to support the claim.

That is entirely what Malcolm Turnbull has been saying, so there is a close relationship there. Then you say:

To begin with, 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.

Any empirical evidence on that for me?

Mr Ergas—It seems to me to be a statement that really follows from common sense. Were rents reduced in retail trade, which is a very significant user of commercial property, I would be very surprised if the reduction in rents did not improve the position of many small and large traders and, by improving the position of those small and large traders, affect both their own prospects and their ability to post lower prices to consumers. I would have thought that that was the sort of statement that was self-evident, and that if one wanted to argue against it one would need considerable acumen to do so. I am not clear, Senator, as to why you would query that statement.

Senator CAMERON—I am asking you. You made the statement I am trying to get some clarity from you. It does not look as if I am going to get that. You go on to say:

The Government claims to be acting on behalf of the 150,000 people employed in the commercial property sector …

Then you say:

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 to lower retail rental costs?

You have been a critic of the government's financial package to boost the economy. Surely, the beneficiaries of that financial package have been those very hundreds of thousands of shop assistants, cleaners and delivery drivers, and we are now moving to the property sector to try to assist those other workers in the property sector.

Mr Ergas—Is that a question or a statement?

Senator CAMERON—A question.

Mr Ergas—I am sorry, Senator, you have lost me. What is the question?

Senator CAMERON—The question is: why would you be raising that the shop assistants, cleaners and delivery drivers are not supported when they have been the beneficiaries of the government's financial stimulus packages?

Senator BUSHBY—What relevance does that have to the bill?

Mr Ergas—Senator, the fundamental point that I am making here, which is, I think, universally accepted at least in economic terms, is that if you assist one area of the economy in particular, if you focus your interventions in a highly selective way to proper, specific sectors, then, whilst the sector that you assist may benefit, you have to consider the effects also on other sectors—and in this case most of the impact of property prices is on rentals for existing properties. When those rentals decline, assuming they were to decline, that obviously imposes some losses on the owners of those properties but also confers some gains, and any sensible economic assessment needs to take both of those into account. The problem with the material that has been put forward to date, and it is pretty scant in this respect, is that it looks at commercial property in isolation, without considering the effects that flow through into the economy as a whole of changes or measures that selectively prop up prices in the commercial property sector.

Senator CAMERON—Why would we come to the conclusion that you do, that the government's position is lacking in transparency, accountability and prudence, when we have got the players in the market saying it is sophisticated and elegantly designed? Who should we believe? Should we believe the actual market participants or you as an academic analysing so-called empirical data?

Mr Ergas—My own instinct on this would be that what you ought to do is look at the reality of the legislation. What that legislation does, for better or worse, is—amongst other things—exempt what is important conduct from the authorisation procedures and provisions of the Trade Practices Act. By doing so, it prevents the kind of transparent assessment of potentially anticompetitive conduct that those authorisation provisions are intended to catch. As such, it seems to me to be seriously lacking in transparency. Would the immediate beneficiaries of government largesse be supportive of that largesse and also want it not to be transparent? It seems to me self-evident that they would indeed be most supportive and desirous of it being as opaque as possible. I believe that your role is to probe that.

Senator CAMERON—Mr Ergas, it is pretty hard to probe when we get your submission about an hour before you give evidence to the committee. So I just want to indicate to you that, if you want us to probe you a bit more, I would be grateful if you would take some questions on notice after I have had a chance to go through your submission, not just skim it.

Mr Ergas—Absolutely—and again I do apologise for the delay. I am very happy to do that.

CHAIR—Thank you. Senator Eggleston.

Senator EGGLESTON—Mr Ergas, we are told that the driving issue behind this legislation is the significant withdrawal of foreign banks from the commercial property market. What evidence is there that that is actually occurring? I also note that on page 12 of your submission you refer to the fact that ‘one of the major problems with the proposal’ is ‘the moral hazard that it creates’ with the existing banks. So would you like to just comment on those two points.

Mr Ergas—Yes, indeed. With respect to the first, I do not believe there is any evidence at this point of withdrawal on any significant scale by commercial banks from commercial property, and I cite the views that the Reserve Bank has expressed in that regard, which I believe to be well-informed views, and also what evidence there is in the public domain with respect to the funding of commercial property.

On the issue of moral hazard, the basic problem with this proposal is that where you have loans that are perhaps of low quality—they have had their quality deteriorate or have been revealed over time to be of poor quality—it may well be that the holders of those loans will have a very strong incentive to try to exit from those loans and that they may now have a lower penalty way of doing so because they may be in a position to, if I may use a colloquial term, off-load those loans on to the new entity. When they do so, of course, the result would be to aggravate the very problem that the entity was intended to resolve. Bear in mind that at the moment a factor that tends to make lenders in the syndicated loans reluctant to pull the plug on a loan—to withdraw from it or refuse to refinance it—is that, if they do so, they may reciprocate the liquidation of that development and take a loss on any other amounts that are owed to them by that project. At the moment they may be in a position where they will refinance a project so as to avoid that project being terminated and any losses associated with it being realised at their expense. Here what they would have is the ability to shift that loss, to some extent, on to the taxpayer. Particularly in a situation where you have cooperation among the shareholders patting each other on the back, as it were—‘You pat my back and I’ll pat yours—you could end up with rather poor-quality loans, in fact, being shifted into this entity and ultimately being borne by the taxpayer.

Senator EGGLESTON—Time is short, so I will just ask you questions on one other subject—that is, the decision to exempt this entity from the competition provisions of the Trade Practices Act. Wouldn’t that, perhaps, act to diminish competition? Doesn’t it raise issues about the good conduct of this sort of entity if it is not subject to the ACCC and the Trade Practices Act, particularly with reference to clause 16 and the possibility of cartel formation?

Mr Ergas—Indeed that is the case, and I am, frankly, amazed that the government, given the very strong line it has taken in respect of cartel conduct, would introduce legislation which exempts a grouping of the four major banks from the provisions of the Trade Practices Act. I believe that that is extremely unfortunate both in terms of the potential costs to the community of any price-fixing behaviour that might be associated with it and also, more broadly, in that it sends exactly the wrong signal about the value and importance of the Trade Practices Act and of ensuring that that act is properly enforced.

Senator XENOPHON—I will go back a few steps. Firstly, last year the Commonwealth provided a guarantee for the banks, and there has been a criticism that that tightened up or further consolidated the role of the big four banks and that lending has been less competitive as a result. Is that a concept you would agree with?

Mr Ergas—I think the situation is still evolving, but what is clear is that, in the context of the global financial crisis, experience internationally is that that has placed some constraints on the ability of new and entrant sources of finance to compete vigorously in the market.

Senator XENOPHON—There is a concern that, as a result of the bank guarantee, there were some unintended consequences. One of those consequences was a tightening up of lending, in a sense—a further consolidation of the power of the big four banks, referred to in today's *Financial Review* by the Chairman of the ACCC, Mr Samuel. Some are saying that the looming problems in the property market are a further unintended consequence, in part, of the bank guarantee and that you need to do something to rectify a consequence of the earlier measures of the government. Do you think there is some truth in that?

Mr Ergas—Whatever its difficulties, I am not convinced that the bank guarantee has caused immediate problems in the property market, though I can see ways in which it could do so. If it weakened non-bank lenders' ability to compete in that market then it would indeed have that effect. But if that were the case—in other words, if the effect of the bank guarantee were to limit the ability of non-bank lenders to continue to compete in that market and hence make refinancing increasingly dependent on the major banks—I would not have thought that a good policy response would be to encourage the four major banks to come into what looks like a price-fixing arrangement under the auspices of the Commonwealth.

Senator XENOPHON—Further to that, there is a suggestion that, as a result of the bank guarantee last year, there were many billions of dollars that flowed out of property trusts back to the banks. We were aware of some liquidity issues with some of those trusts following the guarantee being announced. Is that relevant in the context of what we are considering here, in the sense that, perversely, property financing is a bit tighter as a consequence of the further consolidation of the lending power of the big four?

Mr Ergas—I believe there is evidence that the effect of the bank guarantee was to lead to a shift in the availability of finance, as between the major banks and some of the non-bank financial operators, in much the way you suggest. The impact on commercial property would obviously depend on the extent to which the banks that are now in a better position because of the bank guarantee were willing to step in and make more funding available and how that compares to any loss of liquidity that may have occurred for the non-bank lenders or the non-bank sources of finance. So there is a bit of a balancing that needs to be effected. Again, the bank guarantee, be it by actions or design, has consolidated the position of the four major banks, which are generally the beneficiaries of that guarantee. To that extent, I would argue that it is not a sensible policy response to then set up what amounts to a price-fixing arrangement that involves those four major banks.

Senator XENOPHON—Mr Fahour, the interim CEO of ABIP, rejected any suggestions that one of the outcomes of ABIP would be to accelerate foreign banks getting out of the market. He said that they would almost have a guaranteed price of their assets because of ABIP. Do you see that as a potential outcome? Mr Fahour says that a foreign bank's presence in Australia would not be governed by just one or two investment decisions and that you would not get them bailing out on the basis of ABIP.

Mr Ergas—I believe that the foreign banks' decision to participate or not participate in the Australian market really depends on rates of return in that market relative to rates of return overseas. Rates of return in the Australian market have to date been such that the foreign banks have had continued incentive to operate in this market. However, there will always be some distressed loans. What the proposal does is create a mechanism by which some of the losses from those distressed loans, rather than being slated home to the shareholders of those foreign banks or the lenders to those syndicates generally, would be shifted onto Australian taxpayers. That it seems to me is an extremely undesirable outcome both from the perspective of Australian taxpayers and in terms of the long-run interests of the sound development of the commercial property industry in Australia.

Senator BUSHBY—We have heard a lot of evidence today, as Senator Cameron noted, from businesses who are affected and Mr Fahour, who is directly involved. I want to correct the record in relation to one of the things that Senator Cameron said. Senator Cameron said—and I think I am fairly accurately quoting him—that all businesses who appeared before us today argued strongly that there is an impending crisis. I suggest that that is not exactly the case. They all said that we need to have a mechanism of this kind and it should be strongly supported out of contingency or risk management in case there is a breakdown in commercial lending in banks. Would you say there is an impending crisis? Do you think there is any benefit in taking contingent actions to protect against the possibility of it?

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. Hence, I am sceptical of the merits of establishing such an entity if the sole purpose of that entity is to be there in the event that such a crisis should occur. My scepticism in that respect is made all the more acute by the fact of it being an entity that involves the four major banks and that has the exemption from the competition provisions of the Trade Practices Act.

Senator BUSHBY—We heard earlier that it is a contingency fund only, and that is a direct quote from Mr Fahour. He said that the evidence of success would be if it never writes a loan. He said they will be a low-risk lender to commercially viable projects and it will be more stringent in its lending practices and standards than will the major banks. Given all of that, how do you see it actually working? Will it actually provide the level of confidence that it is argued that it will given that it will only lend to top-quality projects rejected by other branches and do so at a premium to its shareholders?

Mr Ergas—To my mind the best way of providing confidence to the economy is to operate sound macroeconomic and microeconomic policies. Obviously two key components of sound policies are, first, prudence in the use of taxpayers' money and, second, that one recognises and gives full force to the important role of competition in the economy and of the Trade Practices Act in particular. On both of those accounts I would say that, if what one is concerned with is giving confidence to the economy, there are much better ways of doing it. As regard to the lending practices of this entity, I do not see anything in the legislation which requires it to behave in the way in which you suggest it will.

Senator BUSHBY—I will just interrupt you there. I pushed Mr Fahour on this. He told me that they are developing rules, which we may or may not have access to prior to the time that we decide whether to pass or amend the legislation, that will make it clear that that is the case. So I wait with bated breath for that.

CHAIR—We might like to ask Treasury about that. We are running short of time, Senator Bushby, and you are running short of time to question Treasury.

Senator BUSHBY—Okay. Mr Ergas, I thought you should know that before you continue your answer.

Mr Ergas—With respect, those rules are going to be every bit as good as their implementation, and even with those rules I remain concerned about the possibility that market participants will palm off onto the taxpayer the liabilities that they wish to avoid and that, in the process, we will construct an entity that is exempted from the competition provisions of the Trade Practices Act in an area of the economy where, if you read Mr Samuel's statements reported in the press today, competition is of vital importance for ensuring consumers derive the benefits that they can legitimately expect.

CHAIR—Thank you, Mr Ergas, for appearing by teleconference this afternoon.

Mr Ergas—Thank you.

[4.41 pm]

BRAKE, Mr Roger, Principal Adviser, Financial System Division, Treasury

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

CHAIR—Welcome, gentlemen. Would you like to make an opening statement?

Mr Murray—I would like to first make some quick introductions, without taking up much time, and then quickly introduce our submission, which we put to the committee last Thursday. I am the deputy secretary in Treasury in charge of policy coordination. Even though I was not involved in the early parts of the formulation of the policy around ABIP, I was in charge of the negotiations with the banks on this. David Martine is the head of our Financial System Division and he has also been heavily involved in both the formulation of the policy and the negotiation. Roger Brake is a principal adviser in that same area. He led the team for those negotiations. Steven Morling is the head of our Domestic Economy Division. He did the work on modelling the employment effects in relation to the commercial property market.

I do not want to say too much about our submission. I would rather answer your questions and leave you to ponder our submission. Our submission basically tries to set out the rationale for setting up an instrument like ABIP as a contingency to have in your top drawer, if you like, in the case of a precipitous withdrawal of foreign bank lending in the commercial property sector. We would see the commercial property sector as fairly pivotal between the financial sector and the real economy, and I can elaborate on that in answer to questions.

The submission also outlines for the Senate the specifics of the ABIP proposal itself—how its legal structure and its governance arrangements would work and how its funding and pricing arrangements would work. We have one appendix in relation to the lending criteria, which we can elaborate upon, but we also want to add another appendix, which would be appendix 5, and that is on the pricing principles agreed between the banks and the Commonwealth. We will table that today for you to ponder, but there may also be questions in relation to that.

CHAIR—Thank you. I take it you would not agree with the statement that Mr Ergas just made about ABIP being a way for banks to find money to replace liabilities that they want to avoid in the commercial property sector.

Mr Murray—That is not the objective of this proposal. This proposal is very much related to what might happen in the Australian financial sector in relation to commercial property because of consequences of the credit crunch that is happening overseas. In terms of the credit crunch, a credit crunch is when the financial markets actually stop operating properly. In many instances, particularly overseas but also here, certain markets have closed altogether. The proposal here is therefore not to deal with adjustments that will necessarily go on during this current economic downturn in the commercial property market—and in that sense I am totally in agreement with what Mr Ergas said about those adjustments—but to ward against prices plummeting beyond fundamentals because of a withdrawal of foreign capital in particular, because of issues around liquidity in their home markets rather than in the Australian market. In that sense, it is very much about trying to address what we would see as market failure in relation to the international credit crunch. In the same vein, it is very much a contingency plan that in normal circumstances you would hope would not be necessary but, in the event of significant uncertainty that we now face, a sensible contingency to have in the top drawer.

CHAIR—Appendix 5, which you have just circulated, is on the ABIP pricing issues. Do you feel that it addresses some issues that were raised earlier about the rules for commercial viability? I think it was expressed in terms of wanting to know the rules for commercial viability before the bill passes parliament.

Mr Murray—The pricing principles that are outlined in appendix 5 first of all relate to what would be the pricing of loans going into ABIP from the shareholders of ABIP, what would then be the consequential pricing going out and how we would price a small premium to the market. For obvious reasons, this is supposed to be a lender of last recourse facility. Secondly, it looks at what the pricing would be over the guarantees that would be issued by the government in relation to borrowings by ABIP itself in the marketplace. They are the pricing issues in appendix 5. The issues around lending and the lending criteria are, I think, in appendix 2.

The important issues in terms of evidence that has been presented today in questioning, in particular, are in relation to what is financially viable, and that is a very good question. Basically, the lending criteria that would be followed by the ABIP board would be in accordance with the sorts of lending criteria that the banks are carrying out anyhow, and of course all of those criteria are being re-examined given the re-examination of risk going on in the whole financial market. The two most important areas there are the loan to value ratios that apply to the lending that ABIP would do and, in relation to that, the business case and therefore the underlying forecast of the income to interest cover in relation to the assets that ABIP would be lending into. They are the two most important criteria. They are the two criteria that would then determine whether this was basically a BB investment, for instance, and, if it is, what sort of commercial pricing that investment should attract, if indeed it is the sort of investment that the ABIP board would want to get involved in.

Mr Martine—The other important point to remember is that the banks have their own money at risk through ABIP and there is no incentive on any of the shareholders, including the government representative or the major banks, to support loans that are less than commercially viable. They have their own money at risk and all decisions have to be unanimous. That is quite an important safeguard to ensure that ABIP will only provide lending to commercially viable projects. The other important safeguard is that, if a major bank is in a syndicate already, they have to maintain their exposure to that syndicate. That provides an important signal that the major bank that is already there is prepared to continue its lending to that particular project. So there are a couple of important safeguards there to ensure that ABIP would only write loans for commercially viable projects.

CHAIR—Rather than the banks avoiding liabilities, they are in fact committing to the liabilities.

Mr Martine—That is correct. They are putting an extra $500 million from their own balance sheet, exposing that to the commercial property sector, and that is at risk.

CHAIR—In terms of primary focus, apart from that refinancing of those straight loans for commercial property assets, appendix 2 talks about refinancing maturing commercial mortgage backed securities and refinancing medium-term notes or equivalent debt securities. Can you explain more about that and how much that widens out the remit of ABIP?

Mr Brake—The objective here is that some commercial property is currently financed through commercial mortgage backed securities as well as loans from banks directly. That has been a significant part of the financing of some property. That market is essentially currently closed so that borrowers cannot roll over those commercial mortgage backed securities. This would provide a mechanism for ABIP to refinance those borrowings.

CHAIR—And that would be under the same kinds of conditions of commercial viability of each of the participants of those mortgage backed securities?

Mr Brake—That is right. Those proposals would be considered in a similar way.

CHAIR—Right.

Senator EGGLESTON—I am very interested in how this proposal was developed. Could you inform the committee when Treasury started working on this proposal and what consultations, research and analysis Treasury undertook to decide on the structure of ABIP?

Mr Martine—We started discussions with the major banks about this issue late last year in early December. Concerns were raised with the government about the possible withdrawal of foreign banks from syndicated loans particularly during the course of 2009 and 2010. We engaged in discussions with the major banks in early December and those discussions continued throughout December and into January in the lead-up to the government's announcement on 24 January. In that time we also had discussions with about a dozen or so foreign banks including what you would describe as the industry association, AFMA, which represents the foreign banks. We had discussions with AFMA. There were about a dozen foreign banks that we talked to I think it was, from memory, in early January.

Senator EGGLESTON—You said you were concerned late last year about the withdrawal of foreign banks and you had discussions with 12 of them this year. How many foreign banks have withdrawn from the Australian market?

Mr Martine—It is important to be careful about one's language. What we are talking about here is withdrawing finance from loans. We are not actually talking about the withdrawal of a bank. It is not as though we are talking about a foreign bank that locks its doors on a Friday and is gone on the Monday—

Senator EGGLESTON—I understand that. I actually meant the withdrawal of finance. I will clarify that.

Mr Martine—It is certainly clear that foreign banks play a very important role in terms of financing a range of sectors in the Australian economy. Commercial property is particularly important and foreign banks have quite a large exposure to the commercial property sector. So there is concern, looking forward during the course of 2009 and 2010—given the current state of the global financial crisis and the current situation that a number of parents of the foreign banks are currently in, particularly in Europe and the UK—as to whether there will be a withdrawal of financing. That is essentially the concern that the government is seeking to address through ABIP. In speaking to the foreign banks, we have tried to get a sense of the extent to which there is that risk.

I think it has been mentioned in some of the previous evidence about the data that it doesn't at present show a significant drop in foreign bank financing. I guess the best way to describe it is that it is very flat. Like all data, this data is only backward looking; it does not give you an indication of what is going to happen in 2009 and 2010. As Mr Murray indicated, the policy intent of ABIP is very much a temporary contingency measure in the event that there is a withdrawal of financing.

Mr Murray—We have been quite pleased that there has been a reasonable amount of stability. If you think that, at the moment, the nominal economy is not growing very rapidly and that there is a certain stability in overall bank lending to business then that is somewhat reassuring. However, what really was concerning to us back in January and what still concerns us is that in our discussions with the foreign banks there is absolutely no guarantee around their position in the Australian economy and no guarantee in terms of what might be the pressures upon them from their head offices. Even though they would obviously want to make the right soundings publicly—and I do not dispute any of the public soundings that they are here to stay—we still remain concerned about the pressures that they are under in terms of withdrawing capital back to their home economies and that this remains a significant risk.

Senator EGGLESTON—ABIP talks about refinancing viable commercial properties. Isn't there some argument that these banks would have no reason to withdraw and that, in fact, they would have a reason to remain as investors in viable commercial properties if the Australian economy is performing better than their home economies?

Mr Murray—You would hope so. The fact that that may not happen is the exact market failure that we are concerned about. You would hope—as the Secretary to the Treasury, Dr Henry, has already said at estimates—that, when ABIP is up and running, it does no business at all. That would be the best outcome. But this proposal is about effects from overseas. In their home markets, the issues may be far beyond the commercial return that they may get from good property assets in Australia, but the effect on the Australian economy could be quite large. That is the whole basis of this proposal.

Senator EGGLESTON—There are some people who question the purpose of having the four major banks involved in ABIP. They wonder why our major private banks are involved rather than a straight out public bank that is funded entirely by the Commonwealth. Why have you chosen this model instead of a single, publicly funded bank or a Commonwealth funded bank, which in that sense is public?

Mr Murray—I was not here when the actual proposal was developed; however, I presume that there are various models that could be looked at. In maintaining viability in terms of the proposal you want to go ahead with, I think to have the main alternative sources of finance to foreign bank capital—that is, the four majors—involved and have their skin in the game actually brings some commercial focus and stability to the proposal that you are trying to put forward. There has been some criticism that this is yet another example of a government bank. I think that criticism would be valid if this was a government bank, but it is not a government bank. It will have a hard-nosed commercial edge to it, and I think that is a plus for what you would want to see as a short-term contingency measure.

Mr Martine—To elaborate on Mr Murray's answer, having the major banks with skin in the game is very important with respect to ABIP. Having the unanimous decision making is important. There is no power of direction from government under the ABIP legislation, but it is very difficult to envisage a situation where, if there is pressure by government on the government board member to provide a particular loan that is less than fully commercial, any of the four major banks would agree. They would not agree because they have their money at risk. The dynamics would be quite different if the major banks did not have any of their money at risk.

Mr Murray—I will add one more point to this: is ABIP really then some sort of easy exit strategy for the foreign banks? In relation to having the four majors involved, the incentives there are that they are putting up some extra capital in terms of commercial property, which individually they probably do not want to do because they are probably already fully exposed to the commercial property market and in the current circumstances they probably do not want any more exposure, but through ABIP they are prepared, as a stability measure, to collectively undertake some more exposure. But they do not want to allow this to be an avenue for easy access of their foreign partners in syndicated loans. Why would they want to allow their foreign partners to leave the syndicates easily so that the risk can be transferred partly to them through ABIP? So I think, again, that is another reason why it is important to have the four majors involved in this proposal.

Senator EGGLESTON—Some people raised concerns, though, about corporate governance with the four major private banks there; they feel that their presence means that the ABIP representatives, if you like, will be the agents of the banks rather than acting independently and in the interests of ABIP. Do you wish to comment on that? Is there a conflict of interest through having them involved in this?

Mr Murray—I do not deny that this is an important issue; it is. However, in being a member of this board there are obligations under the Corporations Act to act in the best interests of ABIP; that is why we seek to incorporate this under the Corporations Act. Even though you can take into account your shareholders' interests, that does not in any way override your obligations as a director under the Corporations Act.

Mr Martine—Given that each of the banks is putting forward $500 million of its own capital, I think that it is only reasonable that they get to have representation on the board. But, as Mr

Murray has indicated, the ABIP directors are obliged under law to act in the best interests of ABIP, not in the best interests of Westpac, NAB, CBA et cetera.

Senator EGGLESTON—I guess that, if you have $500 million there, it is a bit of a counterweight when you make decisions to make sure that your own interests are not compromised. There has also been some concern that having the four major banks involved in ABIP may amount to a cartel arrangement. Do you wish to make any comment about that? It relates to clause 16.

Mr Murray—I do not believe it is a cartel arrangement—far from it. I listened to Henry Ergas, 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.

Senator EGGLESTON—There is another view: that the creation of ABIP with the banks being involved may, in fact, facilitate the withdrawal of foreign banks from Australia. Would you like to comment on that?

Mr Murray—I have heard these arguments before, and I think that they are—

Senator EGGLESTON—It makes it easier for them to go.

Mr Murray—I think that that is not right at all. I think there are various reasons why the ABIP proposal does not do that, in fact probably does the opposite. Put it in this context: as the property market faces difficulty there obviously will be occasions where there are either loans to be rolled over or covenants arrangements are called into question because maybe loan to value ratios are rising, and therefore there may be opportunities for foreign lenders to re-evaluate their exposure to particular property and may be under pressure from their headquarters to do so. What does ABIP do in this circumstance? ABIP is there in terms of its lender of last recourse to underpin some stability in the market. That is the first issue. Because it is there as a lender of last recourse and therefore 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.' Also from a lender's point of view, certainly from the four majors' point of view, it seems to me they have stronger incentives to try and keep the syndicates together. Otherwise, given their skin in the game through ABIP, the foreign lenders' exit would really be transferring the risk partly to them and I am not sure why they would want to do that. Finally, from the foreign banks themselves, 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.

So in terms of those four areas my very strong view is that this in fact will assist to keep foreign banks here, not the opposite, as has been claimed. If that was not the case then I am not sure that you would then want to go ahead with ABIP if it was not going to have the right incentives to fix the market failure.

Senator EGGLESTON—An interesting answer. I suggested earlier that foreign banks would probably want to stay in successful investments in Australia. But there we are. I want to ask you about the sort of government representation envisaged on the ABIP board, whether it be a current public servant, a former public servant or some other person of note in the community. How will the government representative report to the Treasury secretary or the Treasurer? Will he or she receive instructions from the government, and how does this fit in with that person's role as a director under the Corporations Act?

Mr Murray—A good question. If I can answer the first part of the question and get Mr Martine to answer the second part of the question. I think I can say that obviously the government is thinking about who should be its representative and therefore chairman of the board with the significant veto power. I would like to be able to tell you those sorts of names and in fact be able to say today who that person is, but the decision has not been announced on that, so there is nothing I can tell you on that. In terms of the role of the government representative, obviously they would need to abide by their obligations under the Corporations Act. They would not be subject to direction by the government.

Senator EGGLESTON—Did you say they would or would not be?

Mr Murray—Would not. What we intend is that the Treasury is in the process of putting together a panel of financial experts that the chairman could call upon for his or her own independent advice before looking at ABIP lending proposals. We have had very strong advice on this proposal anyhow from Credit Suisse, who have acted as our advisers, and we have found this very helpful. 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. As I say, we are intending to put together a panel of advisers from which he could pick to seek advice on particular lending proposals before ABIP. On top of that, of course, ABIP will have its own independent management and chief executive who will be advising the board independently on proposals.

CHAIR—Senator Xenophon.

Senator EGGLESTON—Chair, just one quick question.

CHAIR—Senator Eggleston—

Senator EGGLESTON—Just one really quick one; it is quite important. You have spoken of four independent advisers perhaps—

Mr Murray—Yes, a panel.

Senator EGGLESTON—and you mentioned Credit Suisse. Are you suggesting that the four bank members of the board would not be sufficient to provide advice and that you might have other advisers who may or may not be Australian? Because, if you have been to Credit Suisse for basic advice about the structure, might you not go back to them or some other international banking entity for further advice, rather than use the four banks which you have on the board? And, if that is a likely scenario, why have the four banks there at all?

Mr Murray—To answer the first part of your question, I do not think it would be fair to ask the Australian government representative and chairperson of this board to rely solely on (1) the independent management view on a particular proposal or (2) the views of the other shareholders. He has to come to his own independent view, and in our considered opinion the best way to do that is for him to have a panel of independent advisers. Now, they may or may not be foreign; I do not know who those advisers might be. We have not put that out to tender as yet. I am not sure that whether they are foreign or not is particularly relevant; it is whether they are competent and able to independently give assessments to the chairman of the ABIP board. I think that is what is important—that they are competent and independent. I think that answered your question.

Senator EGGLESTON—It raises more questions, but I will not ask them.

CHAIR—Senator Xenophon.

Senator XENOPHON—Because of time constraints, I am going to reel off probably about 10 questions to be taken on notice, if that is all right. Chair, I do not think we are going to get through them all in the ordinary course of things.

CHAIR—Afraid not.

Mr Martine—Unless they are yes/no answers.

Mr Murray—Yes, we could give yes/no answers!

Senator XENOPHON—I wish! I will just reel off the questions. Firstly, would the whole concept of pricing principles as agreed be considered a price-fixing arrangement? Secondly—unless you want to say yes/no to that?

Mr Murray—No.

Senator XENOPHON—Okay.

Mr Murray—Definitely not.

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

Mr Martine—We did modelling on employment issues and we did modelling on pricing. I would not necessarily categorise it as modelling on competition.

Senator XENOPHON—Okay. I really want to get through these questions, unless the answer is yes/no.

Mr Murray—As to whether we saw competition as a concern, we certainly saw it as an issue. But, in terms of a short-term contingency and lender of last recourse, we are not there to stymie competition through this ABIP proposal. But we recognised it was an issue.

Senator XENOPHON—Sure. This one has to go on notice, because it is not a yes/no question. Why was the section 51 exemption considered necessary? Further, what assessment of competition impacts should there be before granting a section 51 exemption, in terms of Treasury's role? Why was the section 51 exemption used instead of the traditional authorisation route? Further, 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; and will Treasury monitor the impact of that competition? Again, these questions are all on notice. I know you are busting to answer them.

Mr Murray—Are those questions 3 to 7, or are they just three questions?

Senator XENOPHON—They are all sequential questions.

Mr Murray—Okay. I will ask Mr Martine to quickly cover some of those issues, and we can take on notice—

Senator XENOPHON—I am just really worried about time. I will be guided by the chair, because I have got a couple more that I want to squeeze in.

CHAIR—Senator Bushby, do you have any questions to put on notice as well?

Senator BUSHBY—I have some questions; I would like to ask two or three of them.

CHAIR—I am sorry; we are out of time for that. So, if you have some to put on notice, I will let Senator Xenophon finish first.

Senator XENOPHON—I will put two more on notice. Has any work, modelling or assessment been done in relation to this 'moral hazard' issue that even the Property Council acknowledged is 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 a perverse outcome?

Mr Murray—I think we very comprehensively covered that both in answers this afternoon and also in the submission. We have tried to very much focus this as a lender of last recourse; we are not there to bail out distressed assets; and this is an arrangement where, because we are pricing above the market, the incentives are there to keep the syndicates together, not break them up.

Senator XENOPHON—You might want to consider that further. Finally, there is a concern that taxpayers bear more of a risk in terms of the contingent liability than the banks, whose exposure is limited to their contribution. Could you take on notice whether the risk is disproportionate to the benefits to taxpayers?

Mr Murray—I can make some very quick comments. The risk to the Commonwealth and therefore the taxpayer is greater, particularly the further the borrowings by ABIP itself under the guarantee arrangement. I think that is quite clear, and that was intended.

Mr Martine—But therefore the returns are higher. There are fees and equity returns on the Commonwealth's component, but we can elaborate in our response.

Senator BUSHBY—I have some questions to put on notice. In respect of the answer that was provided earlier about the effect of the bank deposit guarantee, it seems to me you are proposing a potentially market-distorting policy measure to correct the effects of a market-distorting measure. I would appreciate your thoughts on that. Who suggested the overall measure—was it an initiative of government or did Treasury propose this particular measure as a way of addressing the perceived issue? In terms of the rules that were discussed earlier by Mr Fahour, will Treasury be involved with the development of the rules, has it been involved in the development of any of the rules so far, how enforceable will those rules be, what degree of parliamentary scrutiny will there be over those rules and what ability does ABIP have to change those rules without parliamentary scrutiny, particularly under clause 7, to expand the focus and the level of activities of the entity itself, given that a lot of assurances have been given today than it really is only a contingency measure and will only be lending on very strict criteria? Is there any requirement on the applicants for finance to have tried to get refinance from any of the big four before they come to ABIP? In terms of cartels, I put on the record a request for access to the email exchanges that you had with the ACCC in January-February of this year. I also ask why in development of the legislation it was decided not to go for a section 51 exemption under the Trade Practices Act, which would have involved a public interest test, and to go for the clause 16 exemption which was inserted into the bill and which avoids the need for a public interest test?

CHAIR—Thank you to officers of Treasury for coming and for agreeing to take those comprehensive questions on notice, and thank you to Hansard and broadcasting.

Committee adjourned at 5.19 pm