

## ANSWERS TO QUESTIONS ON NOTICE

### Treasury Portfolio

## Inquiry into the Australian Business Growth Fund Bill 2019

**Division/Agency:** Financial System Division, Treasury

**Topic:** Business Growth Fund

**Reference:** Spoken

**Senator:** Rex PATRICK – South Australia

### Question:

**Mr Tease:** Not explicitly. As APRA said, there are no regulatory barriers for the banks to do that. I would say it's not common practice in Australia for the banks to get together and to create a separate business entity amongst themselves. So that's unusual compared to what they normally do. Treasury was involved in initial discussions with the banks. The Treasurer hosted a round table early in 2018. Treasury, APRA and the ACCC were involved in that round table to test the interest of the banks at the time.

**Senator PATRICK:** So the banks were there?

**Mr Tease:** The banks were there.

**Senator PATRICK:** Who else was there? Where other players in the market there?

**Mr Tease:** There were banks there, there were some super funds and there were the regulators and Treasury.

**Senator PATRICK:** On notice, could you provide a list of people who attended that meeting?

**Mr Tease:** Sure.

### Answer:

#### **BGF Roundtable – Parliament House – 6 December 2018**

##### *Attendees*

Treasurer

Minister for Employment, Skills, Small and Family Business

Westpac

National Australia Bank

Commonwealth Bank of Australia

Macquarie Bank

HSBC Australia

HSBC UK

Australian Super

Australian Prudential Regulation Authority

Reserve Bank of Australia

Australian Competition and Consumer Commission

Australian Small Business and Family Enterprise Ombudsman

Council of Small Business Organisations Australia

Treasury

**Division/Agency:** Financial System Division, Treasury  
**Topic:** Business Growth Fund  
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**Senator:** Rex PATRICK – South Australia

**Question:**

**Senator PATRICK:** Of course you are! And I thank you for it. Going back to your previous answer, you spoke for about five minutes but you didn't actually go to the question that I put, so I'll try and ask it in a clearer way. We are introducing, I think, \$540 million of funding into the market. What analysis have you done to make sure that we're not crowding out the market?

**Mr Tease:** The analysis has been the work that the Reserve Bank has done, the work that the ombudsman has done and the work that we've done in liaising with small businesses in developing—

**Senator PATRICK:** So you have done some and you can provide that to the committee?

**Mr Tease:** Well, it's in the context of the conversations that we've had with small businesses to get their feedback. The feedback that we have got is very clear on that—that there is a—

**Senator PATRICK:** Can you provide the committee with that feedback and your analysis on this? It's a pretty important point, and one would have thought you would have done some analysis in that space. So, on notice, can you please provide what you have?

**Mr Tease:** As I said, the feedback is embedded in the legislation in the Australian Business Securitisation Fund around the description of the gaps that exist in the market, and it relies very heavily on the data and input that we've had from the ombudsman and the Reserve Bank.

**Senator PATRICK:** So you've got data and you've got input. Someone has looked at this, you say. In the Commonwealth, you don't then write up a report or have notes that examine this and come to conclusions?

**Mr Tease:** We—

**Senator PATRICK:** That's the problem; this is a question of due diligence of Treasury.

**Mr Tease:** There are two ways we can do this. Some of it was embedded in advice to government, which we can't provide. There is—

**Senator PATRICK:** Actually, you can. I'm going to stop you there. Have you read the guidance on witnesses to Senate estimates? Advice to government is not a public interest immunity, so I'm not going to accept that, and the committee can't accept that.

**Mr Tease:** There's other work that we—

**Senator PATRICK:** Can you provide that advice to government, please, to the committee? Take it on notice, and—

**Mr Tease:** Yes, we'll take it on notice.

**Answer:**

As noted in Treasury's verbal response to the Committee Treasury's consideration of the funding constraints faced by small businesses and the likely investable opportunity for the AGBF took several forms.

These include consideration of the work of other institutions on the availability and constraints on small business funding, including the Reserve Bank of Australia the Small Business and Family Enterprise Ombudsman, private sector analysis of funding gaps, surveys of small business access to finance, participation in roundtables with the RBA, small business and their financiers and Treasury's liaison with small businesses and their funders during the creation of the Australian Business Securitisation Fund. The work took this form because of

the absence of a quality data set on small business finance. The feedback drawn from this exercise was consistent:

- There were significant gaps in small business access to funding;
- The nature of this funding was limited and did not always suit the needs of businesses across their different stages of development or different business characteristics;
- External funding was largely in the form of debt, most often requiring businesses to provide residential equity as collateral;
- Equity funding was better suited to a wide range of small business but was limited in availability, difficult to attain and costly to arrange;
- The infrastructure surrounding the small business funding markets was poor, with businesses noting difficulty in obtaining information about sources of funding, limited competition amongst funding providers and slow application processes.

In addition, Treasury analysed the potential investable universe of businesses that would meet the objectives and investment criteria set by the AGBF. This was to inform the AGBF working group of the potential market and to consider the risks of “crowding out”. This work, based on business data provided by the ATO, showed that around 40,000 small businesses would satisfy the investment criteria of the ABSF. This confirmed that the ABSF could potentially assist a wide range of small businesses.

The fund itself will likely invest into up to 30-50 Small to Medium Enterprises (SMEs) per year when it is fully operation. This is a very small fraction of the estimated investable universe. In turn, this universe is itself a very small proportion of the over 2.1 million (2017-18) (ABS: 8165.0 – small medium business defined as employing 200 or less staff) SMEs in Australia. Thus, there is little to no risk of crowding out.

The ABGF is also designed to service a part of the SME funding market that is not well catered for in Australia at the moment. To that end, it will cater to SMEs who either are not receiving sufficient external funding or are obtaining a form of funding that is not well suited to their businesses.

Only one submission to the consultation on the ABGF legislation expressed concerns about the potential impact of the ABGF on that business. Other submissions, including from businesses that fund small businesses or industry associations that represent small business funders were supportive of the contribution that the ABGF will make to the market.

More generally, concerns about “cherry picking” or “crowding out” have an implicit assumption that the SME universe is fully funded and that a new entrant like the ABGF will displace other investors or leave those investors access to a limited number of SMEs. This is inconsistent with current market conditions of funding constraints.

**Division/Agency:** Financial System Division, Treasury  
**Topic:** Business Growth Fund  
**Reference:** Spoken  
**Senator:** Rex PATRICK – South Australia

**Question:**

**Senator PATRICK:** We are talking about making sure there is no advantage, if we have a policy of competitive neutrality. If that is a policy of government, then you must have, as you advanced this proposal, carried out a check to make sure you are complying with that policy. I'm asking you to provide that checking report to the committee, please.

**Mr Tease:** We can't provide that report.

**Senator PATRICK:** Does one exist?

**Mr Tease:** As I said, the issue of competition is, I would say, exaggerated in this point, because APRA is not providing a significant subsidy to the banks. Focusing on the fund alone, I think, doesn't consider the fact that the government is implementing other policies to expand competition in the financial system. The creation of the securitisation fund, which is the book-end of this fund, was aimed directly at increasing competition in the financial system by providing an alternative source of funding outside the banking system. The government's fintech agenda and also open banking is another vehicle to increase competition in the financial system. So, this fund should be seen in the context of a wide range of policies that are trying to increase competition in the financial sector.

**Senator PATRICK:** Once again, it sounds like you may have done some analysis on this. I'm asking you to table that analysis. I could FOI it, but that's a frustrating way for me to do that. I would like to think that you are open and transparent with the Senate.

**Mr Tease:** We are.

**Senator PATRICK:** So you will take it on notice?

**CHAIR:** Perhaps you will take it on notice to see what you can provide to the committee in that regard.

**Mr Tease:** That's right.

**Answer:**

The issue of competition was considered in the development and design of the fund. Treasury and the working group consulted closely with the UK BGF to consider its impact on the broader SME funding market in the UK since its creation in 2011. There was no evidence that that the UK BGF had a detrimental impact on competition in the UK market or crowded out other funders:

- The UK BGF has invested in 285 companies. This is a very small part of the investable universe. This will be the case in Australia;
- The UK BGF has developed alongside a more active funding market for SMEs in the UK. The UK BGF considers that its creation has been a catalyst for these developments, by assisting in the development of broader market infrastructure around SME funding and a stronger culture and focus on SME funding.

The starting point in Australia is one of a general funding gap for SMEs, a predominance of debt funding, limited access to equity funding, or the provision of equity funding via venture capital or private equity firms that did not suit the needs of many SMEs, particularly those

whose owners who wish to retain control of their businesses and who desire a long-term funding source.

The AGBF is designed to provide funding for these types of firms. In filling this gap by adding an alternate source of long-term equity funding, the AGBF will provide services largely absent from the market rather than displacing existing funders. As noted previously, Treasury estimates that the investable universe of SMEs for the AGBF is around 40,000. With investments of around 30-50 SMEs a year, the ABGF is unlikely to crowd other lenders out of this market.

By providing services largely absent from the SME funding market the ABGF will boost competition in the broader market by providing alternative sources of funding to the types of SMEs in its investable universe who would have had to otherwise seek external funding that may not have been suitable to their businesses.

The Fund has also been designed to ensure that it does not have a detrimental effect on competition. All investments by the Fund must be made on commercial terms, requiring returns consistent with the risks of the underlying investments. No SMEs will receive subsidised funding from the AGBF. In effect, the ABGF will compete for business on similar terms as other funders. Also, the Fund remains open to other investors at par for one year after it is created. This will enable a range of other investors to become shareholders in the Fund.

As noted in verbal evidence, the equity-focussed ABGF is embedded in a Government agenda of boosting competition in the financial sector — the Australian Business Securitisation Fund, fintech agenda, open banking and comprehensive credit reporting. It should be viewed in that context and as a book end to the debt-focussed Australian Business Securitisation Fund.

**Division/Agency:** Financial System Division, Treasury  
**Topic:** Business Growth Fund  
**Reference:** Spoken  
**Senator:** Rex PATRICK – South Australia

**Question:**

**Senator PATRICK:** Can you please, on notice—and I accept that you might want to advance public interest immunity—provide the governance arrangements to the committee and the investment mandate, as it sits now?

**Mr Tease:** I can provide them on a high-level basis, as I have done now.

**Senator PATRICK:** No, no. To be very clear: where you are up to now. You're entitled to say yes to that or you can say no.

**Senator KITCHING:** The specific mandate.

**Senator PATRICK:** Yes, the specific mandate, the specific governance, as they are drafted at this point in time. If that's not possible, have the minister advance public interest immunity.

**Mr Tease:** Okay.

**Answer:**

The Treasurer has decided to claim public interest immunity in respect of the draft legal arrangements for the Fund, which includes the investment mandate of the Fund and governance arrangements provided for in the Shareholders' Agreement. This claim is being made on the ground that the documents sought are commercially sensitive and confidential. These legal arrangements are being negotiated on a confidential basis, and the terms of the arrangements will be confidential, because the matters included in these legal arrangements are sensitive to the investment posture and commercial arrangements of the proposed shareholders.

The release of the draft legal arrangements of the Australian Business Growth Fund could have the following negative impacts:

- The release would unreasonably and adversely affect the other proposed shareholders' business or commercial affairs, as it may reveal sensitive information about the investment posture and commercial arrangements of these shareholders.
- The release could jeopardise the conclusion of these arrangements and the establishment of the Fund, if one or more shareholders were unwilling to continue to participate as a result of the disclosure. This would mean that the Government would not achieve its policy objective of increasing the availability of patient capital for small to medium businesses.
- The release would prejudice the ability of the Treasury to enter into similar kinds of arrangements in the future, or to otherwise obtain commercially sensitive information for the purposes of achieving policy objectives of the Government.

**Division/Agency:** Financial System Division, Treasury  
**Topic:** Business Growth Fund  
**Reference:** Spoken  
**Senator:** Rex PATRICK – South Australia

**Question:**

**Senator KITCHING:** What's the difference? Why do you have some independent directors. Who are they and how many are there going to be?

**Mr Tease:** At this stage there will be three.

**Senator KITCHING:** Three independent directors. Who is going to appoint them or control the process and the criteria by which they might be appointed?

**Mr Tease:** Well, the criteria would be the contribution that they can make to the oversight of the company.

**Senator KITCHING:** 'The oversight of the company'. So they could be not necessarily equity holding, but they could be—

**Mr Tease:** None of them will be equity holding.

**Senator KITCHING:** But they could be, for example, a governance expert.

**Mr Tease:** They could be an investment expert. They could be an investment expert.

**Senator KITCHING:** The fund is not going to be a Commonwealth company; is that correct?

**Mr Tease:** That's right. It's going to be incorporated under the Corporations Act.

**Senator KITCHING:** When you say 'the Corporations Act', do you mean the Commonwealth corporations law? Is that what you mean?

**Mr Crabb:** Yes.

**Mr Tease:** Yes.

**Senator KITCHING:** So it won't be subject to the Public Governance, Performance and Accountability Act?

**Mr Crabb:** There will be some requirements. The PGPA Act—

**Senator KITCHING:** But it's not a Commonwealth—

**Mr Crabb:** It's not a Commonwealth company, but there are still provisions in the PGPA Act that it—

**Senator KITCHING:** How are you going to do that? Are you just replicating the provisions of the PGPA Act into the constitution of the entity? Is that what you're doing?

**Mr Crabb:** No. The provisions relate to reporting. So, as a shareholder, we will, as will other shareholders in the BGF, get sufficient information to allow us to meet the obligations that the PGPA Act imposes.

**Senator KITCHING:** But the PGPA Act will not apply, because it is not a Commonwealth company. So, if it's a company established under the corporations law, it's not a Commonwealth company. What I'd like to know is how you are putting across the provisions of the PGPA Act that you are going to apply to a company established under the corporations law.

**Mr Crabb:** I'm sorry, I can't provide the exact provision for you here.

**Senator KITCHING:** I'm happy to have that taken on notice, Chair. Could you send that back?

**Senator KITCHING:** Yes, and I also appreciate it's 20 minutes to seven. How is it going to report to the parliament?

**Mr Crabb:** In a number of ways, including the obligation on the Treasurer to report its initial shareholding decision to take a shareholding in the fund and any change in that shareholding. That is a requirement of the PGPA Act.

**Senator KITCHING:** Why would the Treasurer, as a representative of the Commonwealth, change the shareholding?

**Mr Crabb:** There could be a number of reasons for that. All I'm saying is that that's what the law requires us to do—to announce when we take a shareholding in a company and when we change it.

**Senator KITCHING:** Are there any other reporting requirements?

**Mr Crabb:** Yes. The Treasury annual report, which again keys off the PGPA Act, will require the Treasury secretary to report against the performance of the act.

**Senator KITCHING:** You can take this on notice. Are there similar entities set up under the Corporations Law that have any requirements from the PGPA?

**Mr Crabb:** I think that might be where the confusion is. So the company is not reporting; the Commonwealth is reporting.

**Senator KITCHING:** No, I understand. What I would like to know is if there are any entities that already exist that are in the same or similar position.

**Mr Crabb:** Find a company that the Commonwealth has invested in where there is this scenario?

**Senator KITCHING:** Yes, and where you've kind of got a bit of a hybrid. Is it a hybrid?

**Mr Crabb:** I don't know. I'm not sure how easy that would be to find.

**CHAIR:** Take it on notice, have a think about it and see what you can come back to us with.

**Senator KITCHING:** As an extension of that: would you be reporting on this fund at estimates.

## **Answer:**

The AGBF will have tight and multi-layered governance arrangements. In broad terms, these include the external governance arrangements above the Commonwealth's investment in the Fund, the external governance arrangements above the private shareholders in the Fund [via the Corporations Act] and those embedded in the Shareholders' Agreement, which define the governance around the operations of the Fund and the rights and obligations of shareholders. As noted above (pages 6-7), the Treasurer has decided to claim public interest immunity in respect of the draft legal arrangements for the Fund, which includes the investment mandate of the Fund and governance arrangements provided for in the Shareholders' Agreement.

For the Commonwealth, the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) requires the Government to report to Parliament.

### *Section 72: Minister to inform Parliament of certain events*

Under section 72 of the PGPA Act, there is a requirement on the Treasurer to inform Parliament about the Commonwealth's involvement in a company and changes to that involvement over time (listed events). A notice of the event is to be tabled in each House of the Parliament as soon as practicable after the event occurs.

### *Section 46: Annual report for Commonwealth entities*

The Treasury's annual report under s46 of the PGPA Act will be required to include a report on the operation of the BGF legislation.

### *Financial reporting*

The Commonwealth would need to equity account its ownership share of BGF under AASB 128 (Investments in Associates and Joint Ventures) in the Commonwealth's consolidated financial statements (CFS).



This would require the Commonwealth's investment to be initially recognised at cost and subsequently be increased or decreased for the Commonwealth's share of the change in BGF's net assets after acquisition date.

The Commonwealth's share of ABGF's profit or loss after acquisition date would also be recognised in the Commonwealth's consolidated income statement.

In Treasury's General Government Sector statements, the Commonwealth's investment in ABGF would be reported as an equity investment measured at fair value. Fair value can be measured using either Discounted Cash Flows (where reliably measurable) or investee net assets.

#### *Australian Business Growth Fund Bill 2019*

Section 21 requires a review of operation of this Act as soon as possible after the third anniversary of the commencement of the Act. The review must include a review of the effectiveness of this Act in meeting its objectives. The Minister must table the review in each House of the Parliament within 15 sitting days of that House after the report is given to the Minister.

In addition, the ABGF requires a review to be conducted after three years and for this review to be reported to Parliament. The Fund's annual net performance will have an impact on the Commonwealth Budget and will be reported in Budget papers as will the value of the Commonwealth's shareholding in the Fund.

The ABGF's Shareholders' Agreement defines the governance arrangements of the operations and investments of the Fund. These are consistent with a Corporate Entity involved in the investment of shareholders' funds. In broad terms:

- The objectives of the ABGF: to provide established SMEs with patient capital through minority equity and equity-like investments; operate as a commercially viable entity through investment in SMEs on commercial terms commensurate with the underlying risks of the investments; by providing an alternative longer-term source of capital to SMEs facilitate interstate and international trade
- A Board comprising of directors representing the shareholders and independent directors will set the overall direction and management of the ABGF, reviewing performance, objectives and priorities of the ABGF and senior executive recruitment; determination of dividend policy
- A CEO responsible for day-to-day operations of the ABGF, design, implementation and compliance with the business plan and budget and the provision of information to the Board. The CEO reports to the Board;
- An investment committee to oversee and approve all investments. The Committee will comprise at least three members of ABGF staff, who are not Directors of the ABGF and have no interests in any ABGF shareholder;
- An investment mandate that determines the investment parameters and objectives for the investment teams and the investment committee;
- Investments will be minority equity or equity-like between \$5million and \$15 million
- A minority investment will constitute a minority equity interest of between 10-40 per cent
- Target SMEs with annual revenue of between \$2 million and \$100 million
- Revenue and profit growth conditions
- Investments must be made on commercial terms

The ABGF's Shareholders' Agreement also defines the rights, obligations and protections for shareholders. These include inter alia, rights to Board representation, voting arrangements around issues including the entry and exit of shareholders, changes to the investment mandate and breaches of legal obligations of shareholders.

The SHA obliges the ABGF to provide whatever information is required to meet Commonwealth reporting arrangements.

*Senate estimates*

Treasury officials will answer questions on the Commonwealth investment in the AGBF.

**Division/Agency:** Financial System Division, Treasury  
**Topic:** Business Growth Fund  
**Reference:** Spoken  
**Senator:** Kimberley KITCHING – Victoria

**Question:**

**Senator KITCHING:** I have to catch a plane. I have some other questions, but I'll put those on notice. If there's a disagreement between the Commonwealth and the banks—for example, in terms of operation or in terms of governance of the fund—how is it envisaged that there would be resolution of that? What do the dispute resolution clauses look like? How are you dealing with that? Obviously, the Commonwealth in some instances could be a model litigant and yet corporations aren't, so how is that considered in this entity? How much say will the Commonwealth have in terms of governance and operation of the fund? How is that going to be set? How does the fund exit investments? I have a series of questions, but I'll put all of those on notice, Chair.

**CHAIR:** We'll need to get them early tomorrow though because they're on quite limited time frames in terms of returns.

**Senator KITCHING:** The questions I've just asked will already be on the *Hansard*, so maybe I'll just quickly zip through them. What's the definition of an eligible SME for the purpose of this fund? Will mutuals and cooperatives be able to access the fund? Some stakeholders have raised concerns that this fund will just cherrypick the best of the SMEs that would already get access to finance in the market already. So what arrangements can be put in place to ensure finance is going to commercially viable companies that would otherwise not get access? Then I had a series of questions on precedence—so the UK model, for example.

**CHAIR:** Senator Patrick probably covered off some of that, so we will get you the *Hansard* transcript as soon as we can.

**Senator KITCHING:** Great. We will start there and, if you are reporting to estimates, I can ask you more questions then.

**Mr Tease:** Just on your points, we have answered some along those lines during the questioning. On some of those dispute resolution issues, they are embedded in the document in a number of ways.

**Answer:**

As noted above (pages 6-7), the Treasurer has decided to claim public interest immunity in respect of the draft legal arrangements for the Fund, which includes the investment mandate of the Fund and governance arrangements provided for in the Shareholders' Agreement.

The Commonwealth's obligation to act as a model litigant will not apply to the ABGF.

SMEs with turnover between \$2 million and \$100 million, including Co-operatives and Mutuals, and can demonstrate three years of revenue growth and profitability and a clear growth vision are eligible for investments from the fund.

In regards to the issue of 'cherry picking', please refer to earlier question (p 2-3).

**Division/Agency:** Financial System Division, Treasury  
**Topic:** Business Growth Fund

**Reference:** Spoken  
**Senator:** Kimberley KITCHING – Victoria

**Question:**

**Senator KITCHING:** When you say 'legal document', are you talking about a memorandum of understanding or a constitution? What are you actually talking about when you say 'legal document'?

**Mr Tease:** These are the legal documents that bind shareholders.

**Senator KITCHING:** Is it a deed? A deed has a different legal status.

**Mr Tease:** Well—

**Senator KITCHING:** You can take that on notice. That's fine.

**Mr Tease:** We're not lawyers, so we'll take that on notice. All of those dispute resolution things that you mentioned are considered in the document. It goes to the issue that we mentioned before as to whether they are legal documents across a range of shareholders. We as one shareholder can't say that we will be providing all of that information. That will have to be discussed—

**CHAIR:** You have taken it on notice.

**Answer:**

The Treasurer has decided to claim public interest immunity in respect of the draft legal arrangements for the Fund. This claim is being made on the ground that the documents sought are commercially sensitive and confidential (see page 6).