Australian Banking Association

08 February 2023

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
By email: economics.sen@aph.gov.au

Dear Colleague

National Reconstruction Fund Corporation Bill 2022

The Australian Banking Association (**ABA**) welcomes the opportunity to provide feedback on the Senate Standing Committees on Economics' (**Committee**) inquiry into the National Reconstruction Fund Corporation Bill 2022 (**Bill**).

The ABA broadly supports the intention of the Bill and the National Reconstruction Fund (**Fund**), which is expected to support and diversify Australia's emerging industry sectors and its economy but has some concerns in relation to the provisions of the Bill relating to the Fund's design, and implementation of the Fund. This includes its proposed priority areas, scope of the investment mandate and how these matters may impact on the crowding out of the private sector market that is otherwise willing and able to invest in these areas.

It is noted that banks already invest in many of the priority areas proposed to be targeted by the Fund, such as renewables, transport and defence. Investments in these priority areas would be better suited towards the beginning of their lifecycle, such as during the research and development or commercialisation phases of a project or business, where it is more difficult for banks to manage the risk profile. Government is encouraged to focus on infant, or prospective infant industries that may grow into strong contributors to the economy that may require up-front government support, rather than some of the identified priority areas that already benefit from traditional private sector investment.

The ABA recommends it being a requirement of the investment mandate to consult with traditional private sector participants before making an investment by the Fund, such as via a panel of financiers. Government should assess the commerciality of each prospective investment and refer it to the private sector where it is sensible to do so from the perspective of return and/or risk appetite.

This should be coupled with a requirement to 'hand over' funding of investments to traditional investors, such as banks, once the risk profile of the investments has been lowered to a range that can be managed by the private market. Such an approach would support the build out of new and domestic industries that attract a higher risk and possible return, leaving traditional investment to the private market to manage, while freeing up capital to re-invest in the next project.

The ABA also considers the Fund should breakeven, rather than return a profit, given the Fund appears to have been designed to support emerging sectors that have great potential but may require the Government's support to grow or cannot otherwise be funded by the private sector. Should a positive rate of return remain a requirement of the Fund, the rate of return should be assessed as an average across Fund's portfolio, rather than in relation to individual investments.

In the Appendix, the ABA has highlighted a series of points for the Committee's consideration to refine the Bill.

If any further information is required in relation to this submission, please contact me

Yours sincerely

Director, Business Engagement and Policy

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

Appendix

The ABA provides the following comments in relation to the Bill and the design of the Fund:

Issue	Comment
Proposed priority areas for investment	Banks already invest in many of the proposed priority areas for the Fund, such as renewables, transport and defence. In order not to crowd out the private market, it will be critical to be clear as to what stage across the lifecycle of a business or project each investment will be made. Investments made towards the beginning of the lifecycle, such as during the research and development or commercialisation phases, may be better suited to government investment. This early-stage investment can support businesses or projects 'get off the ground' and grow to a point at which debt markets can apply sensible lending and credit metrics to the project or company and support it moving forward. It is recommended the Government focus on infant, or prospective infant industries, research and development stage projects and low Technology Readiness Level (TRL) projects that are at the pre-commercialisation stage that may grow into strong contributors to the economy, rather than some of the identified priority areas that already benefit from traditional private sector investment. Generally, and subject to a bank's individual risk appetite and portfolio mix, banks traditionally operate in an environment that yields a more conservative risk profile with lower level of returns. By comparison, investments that yield a higher risk with a higher return or are in relation to unproven technologies, such as quantum technology, naturally lend themselves to capital that can help fill the gap between traditional capital providers, such as banks, and government. The ABA encourages the Government to consult with other State Governments that have similar programs in operation where such matters have been previously considered, such as the Victorian Government and its Breakthrough Victoria Fund and the NSW Government and its Future Economy Fund. This will help reduce duplication of investment across priority areas identified by various Governments in Australia.
Rate of return	The ABA notes the proposed requirement for the Fund, as outlined by the Government, to generate a positive return across its portfolio and conduct operations on a commercial basis. The example rate of return provided in the consultation paper on the NRF released by the Government on 30 November 2022 is the 10-year Australian Government bond rate (3.47% as at 2 February 2023) plus a margin over the medium to long term. It is also noted the Fund is not intended to make investments in projects that support business as usual or low value-add activities. The ABA has concerns with the positive return and considers the investment mandate and the proposed priority areas for investment will need to be carefully articulated so as not to have the effect of crowding out the private sector market from areas in which it has an appetite to invest, or the risk profile can be appropriately managed. Although the ABA notes the Fund is not proposed to provide grants, the Government should consider the provision of grants as a possible alternative to supporting economic and industry development without crowding out traditional private sector investors. The ABA considers the Fund should breakeven, rather than return a profit, given the Fund appears to have been designed to support

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Issue	Comment
	emerging industries that may require government support to grow or otherwise cannot be funded by the private sector. Should a positive rate of return remain a requirement of the Fund, the rate of return should be assessed as an average across Fund's portfolio, rather than in relation to individual investments. Again, this may have the effect of crowding out the private market in these areas as it competes with the Government for the same type of investment in the same priority areas over the short to medium term.
Investment mandate	The ABA notes the proposed factors comprising the investment mandate, as outlined by the Government, including the rate of risk and return. As noted above, the risk profile the Fund can take on should be considered from the perspective of not crowding out the private sector market and reflect a higher risk appetite than that of the traditional private sector. Each of the proposed priority areas and the subclasses within them should also attract a different risk profile based on what the private sector can otherwise fund. As noted above, the priority area of renewables is generally funded by the private market, but its subclasses may not be. For example, the referenced subclass of batteries may be currently funded by the private market. However, this was unlikely to be the case a decade ago during its commercialisation. Likewise, technologies such as 'carbon capture and storage' may be too risky for traditional private sector operators to invest in at present. During this early-stage, the Government can play a role in supporting the build out of these projects and technologies until they are at a point at which their risk profile is lowered. Consideration should also be given to it being a requirement of the investment mandate to consult with traditional private sector participants before making an investment by the Fund, to understand whether or not there is a gap or barrier in the market that needs to be addressed, rather than automatically making the investment. This could support the build out of new and domestic industries that attract a high risk and high return more expeditiously, leaving traditional investment to the private market to manage. Government's engagement with the private sector could occur, for example, by way of an established panel of financiers before it makes an investment into a project or company. At this point, the Government could assess the commerciality of each prospective investment alongside this panel and refer it to the private sector where it is sensible to do so from a return or risk appetite perspective. The ABA also recommends the Bill and the Fund have a policy or requirement of 'handing over' funding of investments away from the Government to traditional investors, such as banks, once the risk profile of the investments has been lowered to a range that can be managed by the private market. This approach will enable the Government to free-up funds from projects that have reached an appropriate stage of maturity or risk profile and re-invest these funds into new projects.