Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO AUSTRALIA'S EXPORT CREDIT ARRANGEMENTS

MS P. SCOTT, Presiding Commissioner
DR W. MUNDY, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON WEDNESDAY, 4 APRIL 2012, AT 9.59 AM

Continued from 27/3/12 in Canberra

INDEX

MS SCOTT: Well, good morning, everyone. Thank you for coming along again today. Welcome to the public hearings for the Productivity Commission inquiry into Australia's export credit arrangements following the release of our draft report on 22 February. My name is Patricia Scott and I'm the presiding commissioner in this inquiry. My fellow commissioner is Dr Warren Mundy. The purpose of this extra hearing today is to continue with our questioning of EFIC to hear back from them on the views presented in our report and the evidence provided then. Because this is a extra hearing for this purpose I won't be taking comments from the floor or questions from the floor at the end of the day.

Hearings have previously taken place in Perth, Canberra and here in Sydney on 26 March. The commission convened this extra hearing to explore the late evidence provided by the Export Finance and Insurance Corporation. Following this hearing we will be working towards completing the final report to government in May, having considered all the evidence presented at the hearings and in submissions as well as other informal consultations. Participants in this inquiry will automatically receive a copy of the final report once released by the government. We like to conduct all hearings in a reasonably informal manner but I do remind participants that a full transcript is being taken. We have scheduled three hours with EFIC. We haven't scheduled a break but we will take a break as we see fit. Participants are not required to take an oath but should be truthful in their remarks. Participants are welcome to comment on the issues raised in other submissions. The purpose of our hearing today is to hear from EFIC.

Complying with the requirements of the Commonwealth occupational health and safety legislation I need to advise you that in the event of an emergency hotel staff will assist us to evacuate the building, and we are to leave to the left of this room. There is an exit near the men's toilet. The meeting point is at Westpac Bank on the corner of Market and York Streets.

I would now like to welcome Angus Armour, appearing for the Export Finance and Insurance Corporation. For the purpose of our transcript I'll get you to identify yourself, and we might then start with our questions. But welcome, Angus, thank you for coming back again today. Also thank you for providing some written material in response to our questions when we met last time. We might turn to that at some stage during the course of our hours together. So it might be the case we might get - Matt, you might want to identify yourself for the purpose of the record?

MR ARMOUR (EFIC): Angus Armour, Chief Executive and Managing Director of EFIC.

MR HOCKEN (EFIC): Matthew Hocken, Senior Adviser, Government and Industry Relations at EFIC.

MS SCOTT: We might start, if it's okay with you, about SME size because we saw this the other day and this is a relevant part of our work and your response to us. In your submission you note on page 75 that banks struggle with smaller firms. You go on to state a number of reasons why this may be so, for example, smaller firms are unable to mitigate losses in the event of non-payment. What metric would you use to describe the firms you're referring to: turnover, profit, particular business model, number of employees? We're grappling with this issue. You've suggested we've got it wrong. What would work best, in your mind?

MR ARMOUR (EFIC): Our approach to this market, commissioner, has been driven very much by a desire to align with the bank models, and that has two causes. Firstly, efficiency, we think that if we can provide our support through the banking system, if we can provide supplemental risk-taking capacity through the banking system that will be the most efficient form to support SMEs, given the typical transaction size. We have aligned with the banking model too from the perspective of promotion and reaching customers with the banks. A function of our mandate is to work with the banks as much as we can. So it's both from our perspective cost-effective and consistent with our mandate to align with the banking model. We think the definitions we have chosen, which are about turnover, as you identify, are the most practical. The banks don't tend to categorise SMEs by numbers of employees, for example. However, I must acknowledge at the same time that government as a whole has quite a wide variety of ways of looking at SMEs and that may be relevant to the particular program or sector that they're concerned with.

MS SCOTT: Okay, thank you for that. Given that EFIC has indicated that their SME clients typically have a turnover between 20 million and 80 million, and I'm drawing that from material provided, does the business that services these clientele generally achieve commercial returns? So if you were asked to concentrate in that 20 to 80 million category, do you think that you would have to cross-subsidise from other parts of your EFIC business?

MR ARMOUR (EFIC): Not explicitly, no. The return question that we discussed last time from our perspective is composed of a number of elements, and the first one we would start with is we do price for risk. So if you look at our approach to pricing for SMEs vis-a-vis the banks, and I think from some of the submissions, you will see that people say we're quite expensive. That's deliberate, this is supposed to be marginal capacity, not fundamental capacity or core capacity. So I don't acknowledge in the first instance that we would need to explicitly cross-subsidise from one area to another on a transaction basis, no. On a portfolio basis it's a more difficult question to answer, commissioner, it really does depend on the size of your portfolio. Obviously if you have a portfolio - and I'm speaking in hypothetical, conceptual terms - of $10 million you're going to have a very different dynamic around your cost and returns versus a portfolio of $200 million. That's just a practical observation.

DR MUNDY: I'm sorry, but roughly how big is the SME portfolio today as it stands?

MR ARMOUR (EFIC): I think this year we expect to sign about $190 million worth of new facilities and the total exposure would be extending at that point.

MS GOVAERT (EFIC): It depends on the drawdowns.

MR ARMOUR (EFIC): Yes.

MS SCOTT: Andrea, just please identify yourself.

MS GOVAERT (EFIC): Sorry, yes. My name is Andrea Govaert, I'm the Executive Director, SME and Mid-Market.

MS SCOTT: So if I put that together, you would see more merit in having a turnover target rather than an employee target for SME-type definitions, and a target range somewhere between 20 to 80 would not be, in your mind, predestined to a be a loss segment of the market?

MR ARMOUR (EFIC): Correct.

MS SCOTT: Okay, well, that's good. Repeat transaction limits. Does the board now, or the decision-maker if not the board, take the number of previous facilities into account when determining whether further support should be given?

MR ARMOUR (EFIC): From the perspective that a past history is an indication of their performance capability, definitely. From the perspective of discriminating for eligibility, no. One of the examples I've given you previously has been you might be dealing with a small firm that is working in four or five different markets, so their ability to go into a new market is a self-contained risk, an issue in itself, versus the other transactions they might have done in the past; but also is an issue of how long they've been established in a particular market. So even if they have been successful in a place like China or Russia over a 12-month period that's not necessarily enough time for them to establish a depth in their banking relationships to continue that activity without our support. We would expect to go eventually; it's not our desire to be with them indefinitely. The pricing, in a sense, will help them to make that choice themselves.

MS SCOTT: You would actually change the price to sort of wean them off your - - -

MR ARMOUR (EFIC): To begin with we price at a very - - -

MS SCOTT: But I would have thought you'd price high initially because of the risks and the unknown nature of the business and then as they establish more and more facilities and over the course of maybe 18 months, two years having contracts with China you might actually, in some ways, lower the price on the basis that the risks have diminished. I can't imagine that you'd be going the other way as a means to sort of wean them off.

MR ARMOUR (EFIC): No, we tend to stay high and - I mean, I'm generalising, commissioner, obviously, but from my perspective across the business we tend to price high and stay high. This is quite a relevant point for both sides of the business, because there are times that we're approached - and I can think of a handful where people come back to us and say, on the big side even, "We're going to refinance. We'd like you to participate but the rate has gone down," and our answer is inevitably no. If you're actually capable of refinancing this facility in the commercial market at a lower rate, then the private market should do all of it. Don't expect us to participate.

MS SCOTT: So I just want to explore then this idea that you might use the price as a means to wean people off. How does that get reflected? Can you talk about how that happens, how you effectively use that as a signal to people, "Well, you know, we're interested but we're not as interested as we were last time when you only had two contracts with China." Could you talk about that and what sort of price differential you start building into the contract to sort of wean them off?

MR ARMOUR (EFIC): Sorry, commissioner, I probably haven't expressed myself very clearly. I think your suggestion was we would start at a certain level and then lower the price as we gained experience with them because from your perspective the risk declines. I think we agree with your logic that the risk declines, but from our perspective that then means that they should move to the private market. That's the distinction I'm making. We wouldn't start lowering our price to retain the business, we would keep the price at a higher level so they would have a commercial incentive to move to the private market.

MS SCOTT: But I thought you said that you would use price as a means to encourage them to move to - I'm sorry, I haven't got a transcript in front of me but I thought that was basically the message you had, that you would also use price as a means to, over time, encourage them to move to the private sector. I'm just trying to work out how that works, what sort of price differential you start building in. Then I guess the time when you end up saying, if they haven't got the message, "Well, look, Fred, we think that you're a big player now, an established player in this market. We think that you could get finance or a facility from someone else besides us."

MR ARMOUR (EFIC): I apologise, if I have miscommunicated previously. The two dimensions I would articulate in relation to our pricing would be firstly, we price at a level to start with that we think would encourage them to use as much commercial capacity as they could right from the beginning.

MS SCOTT: Right, got that.

MR ARMOUR (EFIC): Then we retain a high price throughout our duration with them, again, in order to encourage them to keep using as much and more commercial capacity to the point where they take us out. So we don't - - -

MS SCOTT: You don't actually build it up?

MR ARMOUR (EFIC): No.

MS SCOTT: You don't. Got that, all right, okay.

MR ARMOUR (EFIC): Sorry, can I just clarify that, because I'm thinking over a 15-year time horizon, commissioners. But there certainly have been times when we have repriced because markets have deteriorated.

MS SCOTT: Of course.

MR ARMOUR (EFIC): So that's an exogenous sort of factor unrelated to the firm. We would come back and say, "Well, we helped you for a year in country X," and I can use Indonesia as an example. "We've helped you there but this year, actually, it's going to be significantly higher because of the risk that related to the macroeconomic situation." But that's an exogenous factor, actually, rather than the firm.

MS SCOTT: Can you contemplate any circumstances where you would have an arrangement where you suggest to staff that, I don't know, two transactions within 18 months sounds about right but six doesn't? I mean, are there informal rules that you have or that you think could work - I'm now into the area of exploring our recommendations and seeking your comments on them. Clearly we have indicated that the idea of three transactions and then a serious look and then a going off to the board if the person is coming back for a fourth, fifth or sixth time, you don't think that's a good idea. So what do you think would be the right number and do you have informal rules within the organisation now, and if so, what are those informal rules?

MR ARMOUR (EFIC): I think our argument on this matter, commissioner, is simply if we feel there is a legitimate market gap that we're trying to fill and that we can do that consistent with the mandate, we don't see the basis for imposing a limit on the number of times they can work with us, for the reasons we have outlined previously. There is no question that we constantly test the market, and therefore the market gap, and that goes to the heart of your, "How do you decide whether this is the right transaction for you or not?" but it doesn't relate necessarily to the number of times they've dealt with us, for the reasons we have discussed. So I'm completely sympathetic with your aim, but our perspective on this is that if there is, again, a legitimate market gap and we can fill that gap profitably and consistently with our mandate, then the number of transactions is not necessarily a relevant criteria to decide if we should do it or not.

MS SCOTT: The trouble with that from our perspective is that we think the concept of market gap, to be frank, is quite woolly and difficult to actually - well, difficult to be robust about. Now, I know you have a different view, but if you just take for the moment that's the perspective we have, we're trying to get your reaction about what would be a workable arrangement in relation to a limit on the number of transactions. You said that the idea of three is impractical. You said your market gap analysis is always enough. We don't contend there and we think that the idea of a limit makes sense because of dependency. I think you're acknowledging that dependency could be an issue. Do you have any view about what would be a practical limit if the government went in that direction?

MR ARMOUR (EFIC): I mean, firstly, I'm very sympathetic to your argument at the start that the market gap concept is not as strict as a market failure concept. You made that quite clear in your report and we don't argue with that in our response. In fact, I would like to ask you to acknowledge that we've made efforts with government to try to put a definition around this. If you look back to 2003 there was no definition around this concept. It was based on words in a second reading speech. We introduced the ERS guidelines to give them comfort that we were working with a certain boundary. We introduced in 2006 the concept of at least talking about what the dimensions of that market gap might be, on the basis that would at least give people a platform to have the conversation about how we're undertaking our work. So you have no argument from us that market gap is different from market failure, no question.

MS SCOTT: We have got questions about market gap.

MR ARMOUR (EFIC): Yes.

MS SCOTT: We will get a chance to talk about market gap at length. But just on this basis of the repeat transaction limit, could you just confine your answer a little bit to that. If government was disposed to providing a limit, you suggested three is impractical. If you've got an alternative approach which - I'm acknowledging that you have an alternate approach but it's not one that we have a lot of confidence in. So I'm asking you what, in your view, given your years of experience of the organisation, would be a practical limit?

MR ARMOUR (EFIC): Commissioner, I can't comment on that, frankly.

MS SCOTT: Okay.

DR MUNDY: A number of people who have submitted to this inquiry have said that we were proposing a strict limit. It's interesting that they have made this common error. The limit which we discuss is actually really as a governance and reporting framework that at a point delegated decision-making should end, that should then go to the board. That's one leg of it. The second leg of it is that there needs to be advice provided to the minister. I guess the question is in two parts: why do you seem to be concerned about that advice being provided to the minister? Secondly, what issues do you see around removing the delegated responsibility and elevating it to the board?

MR ARMOUR (EFIC): The first, in relation to the minister then, two observations. Firstly, it's unclear what the minister's role would be in that process. As you're aware from the legislation the minister has no authority in relation to the commercial account, so it's not approving, it's informing.

DR MUNDY: He also has a general statutory capacity to seek whatever information he considers necessary to discharge his duty.

MR ARMOUR (EFIC): I don't argue with that, commissioner. You're asking me about what are the practical issues, I'm talking about that practical issue.

DR MUNDY: I just want to make sure that the Hansard properly reflects the entirety of the legal circumstances.

MR ARMOUR (EFIC): I'm approaching my answer just from the narrow question, which is, you know, what are the practical issues with it.

DR MUNDY: Yes.

MR ARMOUR (EFIC): So I think for most people who are looking at the report, you know, just the lay reader will look at it and say, "Well, hold it, this elevation, what does this mean practically for me as a small firm dealing with EFIC? Does this mean that there is a process where the minister is informed and the minister has a view? How is that view reached? Does the minister then have some role in the decision-making?" I don't think it's unreasonable to infer that you inform the minister for the purposes of changing behaviour. So if your purpose is to change behaviour naturally a small firm will look at it and say, "Well, what does that mean for me? Does that mean can I rely on the credibility of my application to EFIC to obtain the support I'm seeking or is there a larger political dimension that I'm unaware of?" I think that's why people react to it that way, commissioner. Frankly, I mean even if that's not your intent, I think that's how people will read it.

MS SCOTT: Clearly it's not our intent.

MR ARMOUR (EFIC): Yes.

MS SCOTT: I thank you for those comments. I might take a different tack now.

MR ARMOUR (EFIC): Sorry, I hadn't answered his question about the board delegation. Do you want me to do that?

MS SCOTT: Yes, please do, as long as we can keep it short. I've got quite a bit to get through.

MR ARMOUR (EFIC): Okay, sorry. The current structure of our delegations, which I think you have a copy of, reflect risk. There's a purpose for that structure. It reflects the board's role in the governance of the organisation. It's unclear to me the purpose, if you like, of elevating this to the board in a formal way given the nature of the delegations we have and the reporting we currently have. Again, if the board is capable of trusting management to exercise a delegation of up to $50 million it's not clear to me why they would necessarily remove a delegation for doing four transactions rather than three. I think that's just an area that I'm not clear on.

MS SCOTT: On this issue of dependency, we've drawn attention to the number of firms who are your repeat customers. I acknowledge the point you're making and some of the points that participants have made to us that if they're moving into frontier and emerging markets or at every different time it's a different buyer then maybe they should have some greater latitude. I acknowledge that different views have been made to us. But I guess the point I'm making back to you and would like to have your considered view on is that sometimes they are not different markets, they're exactly the same market, and that EFIC is continuing to provide, time and time again, support facilities. So what's the limit on this? We've given the example of the salt producer in WA. When do you think enough is enough and how do you establish that?

If we go back to just the market gap analysis, I'm trying to work out why the market is so under-performing that 10 times later - 10 successful contracts wouldn't be enough to suggest that the market could flourish. Maybe you'd say to me 10 or you might say to me, "Sure, I've got your point about frontier and emerging, it should be 15." We think 20 looks excessive. You're suggesting to us three is too little. So let's try and see where we can get to with each other. You can never think of a number as a useful guidance to your staff or to EFIC itself?

MR ARMOUR (EFIC): In the first instance I wouldn't characterise the market as under-performing. It may have imperfections and usually imperfections relate to time and information, and that's where you see EFIC come in and come out of markets, and why our exposures over a 10 or 15-year period vary dramatically. Conceptually, institutions' risk-taking capability is sticky; to a degree the big banks but I'd say even more so the regional banks.

The performance of an exporter in a market over a six-month period will not have a meaningful impact on their bank's assessment of a country risk. Over a 12-month period I'd still argue kind of not. Over a two-year period you might start to get their attention. So for me individually I tend to think of the institutional stickiness being temporal, being time related and about experience rather than frequency, because - you know, this is unrelated but relevant: most fraud is related to high-frequency transactions. So frequency is not a good indicator of reliability. It's not necessarily relevant at all to the issues that are facing an exporter. So if they're doing a lot of little shipments into Indonesia they're establishing some credibility, but I think it will take a period of time before that will necessarily change the institutional structure, the risk-taking structure of the bank that they're working with.

MS SCOTT: I'm probably going to ask for briefer answers, Angus, because we've just got so much material to cover. You gave us about 96 pages of feedback, which was great to have comprehensive responses, but when we've got follow-ups we'll need to keep the answers a bit shorter. So I think you're basically saying you don't see any merit in any sort of transaction guidance limit at all?

MR ARMOUR (EFIC): I don't see its use or purpose, no.

MS SCOTT: Okay, all right.

DR MUNDY: Mr Hocken, last time you indicated to us that you had a meeting with the then minister responsible for manufacturing, I'm not quite sure which guy - Senator Carr's office. Are you able to advise us who was present at that meeting?

MR HOCKEN (EFIC): Yes. If my memory serves me correctly it was the Chief of Staff and also a representative from the department.

DR MUNDY: Who instigated the meeting?

MR HOCKEN (EFIC): EFIC did.

DR MUNDY: EFIC did?

MR HOCKEN (EFIC): Yes.

DR MUNDY: Did you consult with your minister's office prior to instigating that meeting?

MR HOCKEN (EFIC): I didn't actually organise that meeting myself, so I'd need to check with colleagues whether that was done or not.

DR MUNDY: Are those colleagues here that you could check with them?

MR HOCKEN (EFIC): No. I can come back to you on that, sure.

DR MUNDY: Could you please come back to us by close of business tomorrow on that?

MR HOCKEN (EFIC): Certainly.

DR MUNDY: Is it your normal practice when meeting with ministers other than your own to seek to advise your minister's office that that's what you're doing?

MR HOCKEN (EFIC): Typically I have ongoing discussions with the minister's office.

DR MUNDY: No, please answer my question specifically.

MR HOCKEN (EFIC): Sure.

DR MUNDY: Is it your normal practice to advise the minister's office prior to meeting with another minister?

MR ARMOUR (EFIC): I probably have broader experience and the answer would be no.

DR MUNDY: That's fine.

MR ARMOUR (EFIC): The office itself would understand that we have quite wide relationships within the bureaucracy.

DR MUNDY: The bureaucracy is different to your minister's parliamentary colleagues though, isn't it, Mr Armour?

MR ARMOUR (EFIC): Yes.

DR MUNDY: Okay. Is it your practice when you've met with another minister's office to advise your minister's office of what has been discussed?

MR HOCKEN (EFIC): Yes, we certainly provide feedback to the minister's office.

DR MUNDY: Is that in the way of specific meeting notes, a phone call, an email or is it just something that comes up - - -

MR HOCKEN (EFIC): It can range. It could be a phone call to inform them.

DR MUNDY: So there is no process, formal process, in which meetings with other members of the government by yourself is documented and communicated with your minister's office?

MR HOCKEN (EFIC): Well, as I said, it could range from a phone call, it could be a meeting note provided to the department with a request that the minister's office be informed.

DR MUNDY: So your answer is no, there is no formal process?

MR ARMOUR (EFIC): No, there is - I think his answer - I think that's your interpretation of his answer. His answer would be that there are a number of means that we use to communicate with the minister's office, and one - I can think of examples where I meet with the chief of staff of our minister and then tell him, "I'm going to go around and see your colleagues' offices and this is what we're talking about." There would be times when we brief the board and rely on our departmental colleagues if there is something relevant to pass to our minister. But I think the point we would emphasise in this, commissioner, is as much as we like to think we help people we are a relatively small part of the trade minister's agenda.

The comment that we made last meeting I think still applies, which is he has responsibility for us, he takes that responsibility very seriously, but I don't think he has a great desire to have a steady flow of EFIC information towards him. That's basically our impression. We meet periodically. We're mandated with him again, the Chairman and I. The Chairman and I are meeting with the minister in a couple of weeks' time. We make the effort to brief him directly on what we're doing, and our impression from those discussions is that that meeting periodically, which happens every three to six months, seems sufficient. We brief his office periodically, and again, our impression from the feedback is that's sufficient. We have not had any feedback that suggests that we've been remiss in how we're keeping them informed.

DR MUNDY: Just coming back to that meeting with Senator Carr's office. You discussed your activities with respect to encouraging - sorry, who was there from EFIC, by the way?

MR HOCKEN (EFIC): Angus Armour and myself.

DR MUNDY: You discussed how you thought you might be able to provide assistance with respect to Australian firms getting more of the supply work for major resources projects. Was that sort of the nature of the conversation?

MR HOCKEN (EFIC): Yes.

DR MUNDY: We had this discussion last time in the context of Greyhound, which would not have generally been within Senator Carr's portfolio remit as his general concern would have then been about manufacturing, given the nature of debates around the time and his responsibilities under that act.

MR ARMOUR (EFIC): This discussion also preceded the Greyhound application by a matter of months.

DR MUNDY: So the discussion that went on, was it restricted to a discussion with respect to manufacturing and high-tech services or did you indicate that your vision for this role for EFIC was much broader than that?

MR ARMOUR (EFIC): The purpose of the meeting wasn't to articulate our vision. What we wanted to inform the minister's - the Department, and they agreed that we should tell the minister's office - was - - -

DR MUNDY: Sorry, DFAT was aware of it or the minister's department?

MR ARMOUR (EFIC): DFAT certainly was aware of it but the minister's department was aware of it through all the different interdepartmental things that we do. So the purpose was to say, "You have a government policy here" - and again, 90 per cent of it will be done through other means, other fora - "but there is an EFIC aspect that will support your policy." That's entirely the purpose of the meeting, commissioners. It's not to seek any support from them. This is purely information. We feel that it's one - - -

MS SCOTT: That's fine.

MR ARMOUR (EFIC): Is that enough? I mean, you understand what we're driving at there?

MS SCOTT: I think we've probably gone - - -

DR MUNDY: Continuing on Greyhound, I think it was indicated last week that you'd made an offer to Greyhound. Has that offer been accepted?

MS GOVAERT (EFIC): I'm not sure, because we sent it last week and I think it's still under negotiation.

DR MUNDY: So it's still under negotiation?

MS GOVAERT (EFIC): Yes, the application went in two parts. We had a credit application for 100 per cent cash cover, which was a bridging facility. That letter of offer was accepted and the facility executed. There was a subsequent application which was approved a couple of weeks ago and which we are now in the process of finalising. I'm not a hundred per cent sure whether that letter of offer related to the second part of the facility has been accepted by the client. So I'd have to get back to you.

DR MUNDY: Are you able to get back to us by email to Ms Heaney by close of business tomorrow with exactly the precise circumstances?

MS GOVAERT (EFIC): Yes, no problem.

DR MUNDY: Who authorised the two legs of that offer?

MS GOVAERT (EFIC): Well, we have our normal credit procedures.

DR MUNDY: Sorry, do you authorise it? Is it a matter for Mr Armour or is it someone who works with you?

MS GOVAERT (EFIC): So we have an instrument of delegation, so the Chief Credit Officer would have approved this credit.

DR MUNDY: Okay.

MS GOVAERT (EFIC): Both legs, by the way, so the first and the second.

DR MUNDY: Yes, okay. Last time you indicated, and I think you just did then, that - you were talking about a bond that's 100 per cent cash covered.

MS GOVAERT (EFIC): Correct.

DR MUNDY: Can you just explain - I mean does that mean that you're advancing funds to Greyhound?

MS GOVAERT (EFIC): No.

DR MUNDY: Can you just explain how that works?

MS GOVAERT (EFIC): Yes. So Greyhound was requested to issue a performance bond to Bechtel, and there was a great urgency for this bond. The company asked us to issue the performance bond based on 100 per cent cash cover, which we did. We treated that as a bridging facility because ultimately the aim was to provide a facility with less than 100 per cent cash cover that goes with the milestones of the project. That's the second offer that we've put into place now.

DR MUNDY: So in the event that this cash covered bond was called on for some reason you would provide the 100 per cent of it. You would just provide cash to the extent of the bond if - - -

MS GOVAERT (EFIC): Yes, if the performance bond would have been called we would have paid on the bond, yes.

DR MUNDY: Yes, sorry.

MS GOVAERT (EFIC): Yes. But we would have the benefit of the security, which is the cash cover.

DR MUNDY: Okay.

MS GOVAERT (EFIC): Yes?

DR MUNDY: Yes. Can you remind us what the face value of that bond is?

MS GOVAERT (EFIC): It's around five million, but I don't know the exact - - -

DR MUNDY: But it's of the order of five million?

MS GOVAERT (EFIC): Yes, it is, definitely.

DR MUNDY: Okay. No, that's fine. Is this transaction similar in structure to the arrangements you entered into with Lean Field?

MS GOVAERT (EFIC): No, Lean Field is a combination of bonds and working capital.

DR MUNDY: So precisely how is it different?

MS GOVAERT (EFIC): I guess from a more holistic - stepping back from the transaction level, when companies compete for work in subcontracting for LNG or natural resources, it doesn't matter what, they normally have to issue a performance bond. When it's a smallish company the banks - they do offer these services, so they issue performance bonds as well. However, the security and the size of the company and the size of the contract, the technical competency of the companies, are often a problem for them to get the bond from the bank. So that's when we step in and we offer performance bonds. We can issue the bonds directly ourselves, but what we prefer is to offer bonds through the banks, because again - and it comes back to that migrating into the commercial market issue - what we often see is when the contract is getting advanced and the performance is okay the banks get more comfortable with the risk profile and they take us out. It doesn't happen always but it does.

But a performance bond is one issue that guarantees the performance of the subcontractor, but then there is a working capital element. Obviously the companies also need working capital to fulfil their obligations under the contract. So sometimes we do performance bonds in combination with the working capital; sometimes only working capital, sometimes only performance bonds. There's no hard and fast rule. It really depends on the company.

DR MUNDY: Okay, I get what you're saying. Back to Greyhound. You mentioned that the approach came from Greyhound's chairman. Who is Greyhound's chairman?

MS GOVAERT (EFIC): Well, the CEO, Neil Taylor.

DR MUNDY: Sorry, you said last time that the approach - - -

MS GOVAERT (EFIC): Sorry, then I made a mistake.

DR MUNDY: But do you know who Greyhound's chairman is?

MS GOVAERT (EFIC): I do, but again, I have to come back to you. I don't want to - I'm not a hundred per cent sure. We spoke to him.

DR MUNDY: Yes. Our investigations indicate that it's Mark Mentha.

MS GOVAERT (EFIC): Yes.

DR MUNDY: As far as you know that's the same Mark Mentha who is an insolvency practitioner?

MS GOVAERT (EFIC): Yes, we know about the company, we know the background of the company.

DR MUNDY: So you'll be able to tell me who Greyhound's bankers are?

MS GOVAERT (EFIC): Yes.

DR MUNDY: They are?

MS GOVAERT (EFIC): ANZ.

DR MUNDY: ANZ, and is - - -

MS GOVAERT (EFIC): And there are a number of other banks as well, but I'm not sure whether I want to go into this much detail.

DR MUNDY: Well, I think these are important issues for us to understand.

MS GOVAERT (EFIC): Yes.

MR ARMOUR (EFIC): I think there are certain - - -

MS GOVAERT (EFIC): But could I come back to you by letter?

MR ARMOUR (EFIC): We have, obviously, confidentiality issues.

DR MUNDY: I know all I need to know about Greyhound's bankers, that they are ANZ. Are ANZ or any of its affiliates substantial shareholders in Greyhound Coaches?

MS GOVAERT (EFIC): You know all about this company, right. So the company went through a restructuring.

DR MUNDY: Yes, it's important for us to have this information on the public record.

MS GOVAERT (EFIC): Yes. So the company went through a restructuring and the ownership structure changed. ANZ still has, I think, a residual shareholding, but I'm not a hundred per cent sure.

DR MUNDY: Sorry, it's a residual shareholding? By that, do you mean 5 or 10 per cent or 49 per cent?

MS GOVAERT (EFIC):   I think before I, again, say anything that is not completely correct, let me come back to you bilaterally on this. Because we know the file inside out, so all the information that you want you can get, yes.

DR MUNDY: If you can provide that information to Ms Heaney by close of business tomorrow, that would be helpful. Was this restructuring and this period of corporate stress that Greyhound appears to have gone through a relevant consideration in you looking at why its bankers may have declined to provide it support and does it also reflect upon your own credit assessments?

MS GOVAERT (EFIC):   Yes, of course. We take into account - and we are very well aware of the situation that Greyhound Australia was in when we looked at this contract. I think for us, if you look at it from a credit risk point of view - and why we looked at this transaction quite seriously was because we felt that the company could be given a great opportunity actually in the natural resources sector, you know, where buses are needed, and commercialise a business that they already had. But on the tourist side actually was going through a lot of difficulty, so we felt that it was probably commercially a good thing. You can argue with that, of course.

DR MUNDY: No, sorry, I just want to tease it out a bit. I mean, I have had the pleasure of going to Karratha on many occasions and I don't see many tourists there.

MS GOVAERT (EFIC):   No, that's not what I mean.

DR MUNDY: So, I mean, we were told that they didn't operate in this area, they had never operated in the area and it's, with the greatest respect, not a tourist destination.

MS GOVAERT (EFIC):   No, that's not what I was trying to say. Greyhound Australia is, as you know, involved in vacations - holidaying people - but this is another leg of their business which is the transport to mining sites. We felt that this contract was actually a positive way for the company to turn their business around.

DR MUNDY: Does the previous financial issue - the turning around or their previous distress - does that constitute part of your assessment that they are in a market gap?

MS GOVAERT (EFIC): It is a good question. But normally what we - I mean, our market gap analysis is obviously centred around whether the company is able to get commercial support. If not, one of the considerations - and I'm not saying Greyhound is in that scenario - could be because it's just not a good company. Normally, however, what we do is it is typically companies that are growing very quickly or have larger contracts that their balance sheets not necessarily can support. You see in the submissions that were made, there are plenty of examples of that.

DR MUNDY: Yes, we are aware of that.

MR ARMOUR (EFIC): Commissioners, I can just elaborate on that point, if you want; that is, if you look over a very long period, EFIC has been - on its own and sometimes with the national interest support - been asked to reflect on companies that are, at a point in time, experiencing financial distress. That is a matter of public record with GMH and - - -

MS SCOTT: That's a good point.

DR MUNDY: They typically have been dealt with on the national interest account.

MR ARMOUR (EFIC): Typically.

MS SCOTT: But not always?

MR ARMOUR (EFIC): Not always.

MS SCOTT: Okay. We might just turn back to the issue we visited last time: this integral to resource project. Angus, thank you for providing last night the legal advice that you had some time back. The legal advice relates to - I think the example you used was a storage facility. So some ways I think that is a bit different to a bus company, but I just want to check. It is about, you know, an exporter requiring storage facilities as part of their export operations, where here we seem to be trying now to grapple with things that might be downstream from the operation. So I guess I'm coming back to what can you tell us about the written advice that exists now to staff or existed previously to staff about what is integral to a resource project?

MR ARMOUR (EFIC): Commissioner, I didn't actually review that particular document again before it went out to you, so my memory of it is very poor. But I would repeat the answer I gave at the last time which is this is very much a work in progress. We have not done dozens of these transactions, we have done fewer than a handful. At this stage and, I expect, actually for the foreseeable future, we tend to seek legal advice on every transaction and say, "Well, okay, how does this sit within the legislation in terms of integral." So I think we've given you an example for what we've done, but we wouldn't use that example as a guideline for everything that we're doing.

MS SCOTT: Okay. I just still want to understand what is in scope and what is not in scope, because we know that the tourism sector would see, I guess, export opportunities in a variety of fields. So I've just got two quick questions, I think I know what the answers are going to be, but it's important to make sure I've got it right. If you were approached by a coach company who services passengers to and from Sydney International Airport, do you think they would be the sort of clients you're looking for?

MR ARMOUR (EFIC): No.

MS SCOTT: And a coach service servicing inbound, international tourists in the Kimberley region?

MR ARMOUR (EFIC): I don't really know about the characteristics of the tourism market there, commissioner, but you're suggesting that it is - - -

MS SCOTT: I'm trying to work out why some coaches are A-okay but not coaches for the vacation business, not coaches servicing an airport. Coaches that are integral to a resource project, tick? Other coaches supposedly in the export business, loosely, no? But ones integral to resource project, yes? I'm just trying to clarify what is in and out of scope. There isn't a written piece of paper that helps me on this space, is there?

MR ARMOUR (EFIC): No, commissioner, but again I repeat the advice I gave you last time, I think there are some commonsense tests that any reasonable citizen would apply. A coach company within Sydney and Sydney Airport, anyone stepping off a plane would have lots of options available to them. You need to know, what exactly are you facilitating by providing that service.

MS SCOTT: Okay.

MR ARMOUR (EFIC): There would be other coaches in competition. The Greyhound example, which you are fixed on, is a single-user, dedicated project, which relates only to that project.

DR MUNDY: But with respect to that project, Greyhound was the preferred tenderer within the tendering process, but there was at least one tenderer from offshore.

MR ARMOUR (EFIC): Yes.

DR MUNDY: Presumably, given the wide amount of Pluto construction, there may well be other coach operators, local or regional coach operators, in Karratha who may have been also unsuccessful. So the fact that there may well have been multiple providers available to provide that service. We know of at least two, which we have been told by - - -

MR ARMOUR (EFIC): I can't make assumptions about how many people might compete for the service, but at the point we're involved in, they are the preferred tenderer. The question is whether they will execute or whether the contract will fall to the international company; that is our point of concern.

DR MUNDY: Do you know as a fact that the second tenderer was the international company?

MR ARMOUR (EFIC): I personally don't, no. I would have to inquire.

DR MUNDY: So that wasn't a relevant consideration in your decision making?

MR ARMOUR (EFIC): The competition was certainly a relevant consideration. I don't personally know whether they were number 2 or number 3.

DR MUNDY: Are you able to get back to us, if you are aware, as to how many other tenderers there were, and not wanting their names, but particularly their nationality and whether they were regionally based in Western Australia. Are you able to get back to us on those facts, if you have them? You may not have them.

MR ARMOUR (EFIC): Definitely, commissioner, we will provide what's - - -

DR MUNDY: We would like that information by close of business tomorrow.

MS SCOTT: Moving to a different area, in your supplementary submission to us you have this notion of crowding in, which I have to say I am finding hard to get my head around, but I wanted to understand your perspective on it. Are you effectively saying that, through your involvement in a project, you are able to bring other private capital from elsewhere in the economy to the project you're supporting. That's right, isn't it?

MR ARMOUR (EFIC): No. Private and public capital and usually from overseas; not necessarily domestic capital alone.

MS SCOTT: All right. But some of it could be domestic effectively?

MR ARMOUR (EFIC): From the banking system, yes, not from the insurance.

MS SCOTT: Okay. So your crowding in is you are able to often bring other ECAs involved into the project and you are able to bring some private banks into the project as well. But doesn't that also mean that you have drawn resources from other projects that also could have been exporting?

MR ARMOUR (EFIC): How so?

MS SCOTT: Right. So project A went to the financial sector and for some reason could not attract the support they required. They then approached EFIC and said, "We can't attract the support we require," and EFIC says, "Look, we have assessed your case, we think, in this case, we will be getting involved and, what's more, we'll see if we can attract others to be involved." Your activity means that you are then able to attract not only other ECAs but private banks to this activity, domestic private banks. But if we take it that there is a fixed quantity of money, that money represents an opportunity cost for other businesses. So effectively it could have, the bank which was going to use that on project B, domestic exporter not going to EFIC, is now going to use it on project A, domestic exporter now assisted by EFIC.

MR ARMOUR (EFIC): Commissioner, firstly, I'd like an economic response. I know you wanted it brief, but I'll do as best I can.

MS SCOTT: Okay.

MR ARMOUR (EFIC): An economic perspective and then again a practical perspective.

MS SCOTT: Okay.

MR ARMOUR (EFIC): From an economic perspective, I think as long as we're pricing to market I'm not sure we're disadvantaging the economy as a whole. But coming back to a practical consideration - and this was the point I was trying to drive, but I think I need to emphasise - the private capital we're drawing in is overseas private capital not private insurers.

MS SCOTT: But I thought you said - - -

MR ARMOUR (EFIC): If we're thinking about the same type of project here, in the sense that if we're working with a small firm here, we're already working with the bank, so the bank already has a relationship. From our perspective we might help the bank to do more, but that is not the same as when we use our relationships with Lloyd's of London Insurers or private market insurers in the United States to basically import their capital to help Australian firms. We think that is a very different information symmetry argument altogether.

MS SCOTT: You may be correcting your earlier answer, but I did draw to your attention that it was domestic private banks and you said, "Yes."

MR ARMOUR (EFIC): No, sorry, I said, "Domestic private insurers," and you repeated back, "Domestic private banks," and I said, "No." Where we're drawing in overseas capital - overseas public capital and overseas private insurers.

MS SCOTT: We have received a number of submissions which have indicated that your involvement in the activity means that domestic private banks are therefore then interested in the activity as a result of your involvement. I mean, you must have seen those submissions.

MR ARMOUR (EFIC): But, again, the distinction we make - and we just might be arguing around wording here, commissioner. But from my perspective, if the banks already have a relationship with the client company in Australia - so the Australian bank has an Australian client - I wouldn't argue that we are drawing their capital towards that client; that relationship is already established. What we're helping them to do is to approach a new market, for example; to provide more capacity in relation to a market that is not necessarily - - -

DR MUNDY: I think Commissioner Scott is more reflecting on a number of submissions we have received from Australian banks and their observations about the importance of your presence for their capital to turn up in structured project financing for the resources sector. I think that is what we are driving at here, and I think the point is that what we're trying to ascertain is that if what they say is true, if you were not there, then that capital would be available for lending in other parts of the Australian economy by those Australian banks.

MR ARMOUR (EFIC): I think there are probably a lot of different cases we would probably have to unpick which doesn't go to your objective of being brief in this. But there are some submissions that talk about our capability overseas, for example - - -

DR MUNDY: We're talking about those from domestic Australian banks.

MR ARMOUR (EFIC): Okay. So the Australian domestic banks, when they're talking about, from my perspective - but, again, you really need to ask them to clarify on their submissions, so I'll give you my perspective on it.

DR MUNDY: Sadly, none of them have sought to appear.

MR ARMOUR (EFIC): I am sure they would be happy to have conversations about it. I know some people wanted to appear today and couldn't be scheduled, so I'm sure there are other people who - - -

MS SCOTT: Unfortunately, none of the banks, even when approached, wanted to appear, which I would have to say is very unfortunate. Anyway, moving on.

MR ARMOUR (EFIC): Yes, to come back to your question - - -

MS SCOTT: I guess I'm trying to ascertain, I saw in their submissions and in early material and discussions we had with you, that your activity was able to bring - "crowd in" I think was the phrase you like to use - private funds from domestic sources. Now, you're telling me, "No, no, it's never domestic. It came from definitely overseas, definitely overseas." I'll amend my thinking. But I understood that you were referring - in fact, some of our conversations with these financial institutions have been about their domestic activity.

MR ARMOUR (EFIC): Okay, so I'll tunnel down into the cases. So I think your concern is largely around the big resource projects. Is that right? Because there are - - -

MS SCOTT: We'll make it easier for you and we'll say big resource projects. How's that?

MR ARMOUR (EFIC): Commissioner, I just want to make sure that we're not tangling up SME work in the big project work, that's all.

MS SCOTT: No, all right, we're only talking big.

MR ARMOUR (EFIC): We're only talking big; that's what I want to focus on. So in the big project work, by and large - and there are always exceptions, but I would say by and large - I think that what I would infer from their comments is: our ability to work with other export credit agencies to help them to participate in this market, provides the sufficient funding so that the private banks know that there is going to be bankable proposition.

MS SCOTT: Okay. The crowding in of other ECAs, at other times you indicated - well, you know, I've got that media report about Strings Attached, and you'll recall our discussion about Strings Attached. So on the one hand, ECAs get involved. Other ECAs being involved in projects, you see as potentially detrimental to Australia because they come - - -

MR ARMOUR (EFIC): No.

MS SCOTT: You never see them as detrimental?

MR ARMOUR (EFIC): And I made that clear at the last meeting, commissioner.

MS SCOTT: Okay, so it's never detrimental.

MR ARMOUR (EFIC): A media report is not our evidence; it's not the basis for our argument. What I said last time was we're a capital-importing nation. If foreign governments want to fund our infrastructure, that may be the best solution for our economy but we need to be cognisant and aware in our policy process of all the dimensions involved in that. That's my argument: it's about information and making sure we understand from the policy perspective; that when an ECA participates here they will have other objectives.

MS SCOTT: All right.

MR ARMOUR (EFIC): It may relate to employment, it may relate to resource security; those are the examples I gave last time.

MS SCOTT: Okay, good. So your crowding in other ECAs you see as never detrimental to our interests.

MR ARMOUR (EFIC): I'm honestly not sure how to answer that from the broader policy perspective. My understanding, from speaking with Martin Parkinson, for example - so I have spoken at length with him about this issue - is if foreign capital is available to fund these projects and if the terms and conditions are not distortions, then this is a good outcome for the economy as a whole. I'm not a PhD economist like Dr Martin Parkinson, but that is the message I took away from that conversation.

MS SCOTT: Okay.

MR ARMOUR (EFIC): I don't think I've got either the experience or the background to form a judgment about the word that you used "detrimental". All I can say is that the advice that I've had consistently from Treasury is if foreign governments choose to follow this path, that is acceptable providing there are no distortions.

MS SCOTT: Thank you.

DR MUNDY: I think last time we had a discussion about the extent of the advice your board receives with respect to whether a transaction is or is not within the market gap. I think it was my colleague that alluded to the fact that there was one major transaction which the market gap definition grant is four lines and three words. We've accepted this material for dates in - on a confidential basis but our view is that there's nothing in the words that relates to that analysis other than to name a particular bank concern which we would not intend publishing that could not, under our Act, constitute material that we would not put in the public domain. So do you have any particular issues with us - other than excluding the name of the bank concern which you raised concerns about and which we concur with you - placing that information in our final report so that the evidence which at various points and numerous you claim we have not made out we can actually put in the public domain and obviously make available to the government.

MR ARMOUR (EFIC): If you can provide that particular section to me, I can review it for you. I would add for the record, as I did last time, that whatever is provided in writing is an aid for the discussion that occurs at the board. The Chairman of the board sits on the Commonwealth Bank of Australia board, the Deputy Chairman recently retired sat on the Macquarie Board. We have very experienced professionals in the largely private sector board who know a great deal about the markets. So from their perspective this is a discussion point. They will interrogate and challenge on management on our conclusions and we should not infer that they accept what we write without some interrogation.

DR MUNDY: But you would also accept that the behaviour and standards of conduct for directors of listed companies or private companies or, indeed, government agencies - the purpose of board minutes for a government agency is somewhat different. The documents of public institutions are in part there to provide assurance to others about process. I think you have actually noted there are issues around audit with ability so we will get back to you on the words that we propose to use.

MS SCOTT: Has the board signed off on a definition of major resource projects and related infrastructure?

MR ARMOUR (EFIC): We've not tried to characterise it in terms of dollar value or anything of that nature, no.

MS SCOTT: But an actual definition of what a major resource project is?

MR ARMOUR (EFIC): That's my answer, no.

MS SCOTT: So there's no definition.

MR ARMOUR (EFIC): Resource project defines itself so I'm reflecting only on the word "major".

MS SCOTT: But you haven't sought to clarify what constitutes major, minor and you haven't sought to define what is a related infrastructure.

MR ARMOUR (EFIC): Related infrastructure actually we would have guidance from the Act in how we use the word "related" because we have "related services" as part of our legislation. So we're actually mindful of the word "related". It might sound incidental to you but in fact it's not for us.

MS SCOTT: No, I'm sure it's very important.

MR ARMOUR (EFIC): Sorry, coming back to the word "major" I think again the commonsense test would apply that if I look at the WA government their major project unit doesn't look at anything below a billion dollars.

MS SCOTT: Is that what your staff use?

MR ARMOUR (EFIC): We don't have a hard and fast rule.

MS SCOTT: You don't have a hard and fast rule and the board hasn't signed off on any definition of major resource projects and related infrastructure?

MR ARMOUR (EFIC): Not at this point.

MS SCOTT: That's fine, thank you.

DR MUNDY: And there is no definition of what you mean to the infrastructure?

MR ARMOUR (EFIC): No, again there would be a common usage of the word "infrastructure". I don't think the board can add anything to the common usage of the word infrastructure.

DR MUNDY: So it's the typical vagueness that surrounds that.

MR ARMOUR (EFIC): We have a department of infrastructure, I guess.

MS SCOTT: Okay, next question. Does EFIC typically explore with large corporates seeking its support all avenues available to corporates to obtain debt and equity? I mean, in this concept of market gap, how do you satisfy yourself that all avenues available to corporates have been explored?

MR ARMOUR (EFIC): I think this is actually a very important point you raise, again from our perspective which may differ from yours. The area we focus on - and I'll try and keep it short - is the application that we're seeking. I don't mean that in a literal sense, I mean what is the purpose of us participating, why are we there. So we don't see an equity raising by a listed company as a natural or even sensible substitute for a performance bond to work in Mongolia. Those are not interchangeable elements from our perspective. Nor is it our purview to give them advice on what they should be doing with the structure of their balance sheet and their equity position. So there is a limit even within the Act - and this is quite clear - that within the Act we can't provide advice. So we're careful about what we do.

We look at what we have been asked to do. We look at the conditions surrounding that request and form a judgment there. But your question particularly about a major listed company, while we would - - -

MS SCOTT: I wasn't actually asking about do you provide them advice, I was asking, do you find out from them - maybe I'll make it clearer. Do you examine them to see if they have explored all avenues available before, saying, "Right, well, definitely you're in the market gap." I'm trying to establish how you know they're in the market gap. What efforts do you undertake to explore the avenues available to them, short of coming to you?

MR ARMOUR (EFIC): So I come back to the first part of my answer, commissioners, which is about the application. So we may understand their equity and debt position, they're listed companies and we will certainly review it from the perspective of the risk that we're taking but we look at the application that they're making to us for the support that they ask for and we don't see a performance bond as a natural substitute.

MS SCOTT: We've had a number of firms submit to us which are private - I'm now going to say private entities, private firms who are very keen to see a continuation of their engagement with you and would like to see you have a larger role. An alternative available to that sort of private one would be, of course, to go to equity markets and so on. I'm just trying to work out, do you, in taking your determination that, "Yes, you should keep doing business with these private firms - wait a minute, wait a minute, really there's probably a role for the equity market here".

MR ARMOUR (EFIC): Again, commissioner, I would not tend to offer them advice about what their capital structure would be but - - -

MS SCOTT: I'm not asking you to give them advice, I'm asking, do you take that into account in establishing whether there is a market gap. Yes or no?

MR ARMOUR (EFIC): We would look at the level of equity, yes. We would ascertain that the level of equity was appropriate to the business and the contract that we're being asked to support, yes. Would we suggest to them which is - you know, coming back to the point where we disagreed - that they might use equity for a substitute for what we're doing, no. We would not offer advice.

MS SCOTT: No, you wouldn't offer it but would it affect your determination? If you had a firm that was effectively coming back to you - - -

MR ARMOUR (EFIC): Yes, if they were habitually undercapitalised and coming back to us, that would cause us an issue, there's no question.

MS SCOTT: What about then a large corporate who was approaching you seeking your support but it wasn't clear in any way that they had - I'm trying to establish how you establish that they have not undercapitalised or they haven't - you know, people are doing corporate bonds and Australia's private banks have even indicated to us that they're increasing their exposure to corporate lending at the moment. I want to establish how you know that they're definitely in the market gap when other avenues can be available to them?

MR ARMOUR (EFIC): Again it's a great question, commissioners, because I think it illustrates a number of things. Firstly, if you go back prior to the GFC you would not see EFIC in the markets that you're seeing now. So if you looked at big bonding lines with all the engineering companies, that was not typical work for EFIC. You have the financial statements, you understand that. What happened during the GFC for all our major firms was a contraction in availability. What we provided was basically a safety net. If you look at the actual usage of those facilities, it varies considerably. But it was the safety net that allowed them to tender. From our perspective financially rewarding because we made money by putting them in place, a necessary safety net if the commercial market was unavailable but again priced so that they would use the commercial market first and now starting to come down which is exactly what we should do, step in, help in the crisis, step back, which is exactly what we're doing now.

You're concerned with activity over the past three years that didn't take place for the previous 10 years and I expect it won't take place for the next four, you know, but it's going to manage again. It's a temporal issue caused by a momentary issue in the markets. There is one firm - and obviously for confidentiality reasons I won't disclose - that was growing considerably and had constraints even prior to GFC and I was aware of that, coming back to your question, how do we know? Because people were calling us from London saying, "This firm is up against its limits, can you help us with this firm?" So as remarkable as that might seem, some of our companies occasionally are so big that even on a global scale they're tapping out the international market considerably. But by and large this is an issue of time or, in some cases, location.

DR MUNDY: So that firm that you've mentioned which you don't name, it was up against this, did you then assist them?

MR ARMOUR (EFIC): But we assisted them in particular markets. So this was - again, if I give you too much detail then I identify the firm. So where we provided assistance to that firm was working in emerging and difficult markets, not here.

DR MUNDY: Was it your view that the market generally which had perhaps established these banks, insurers, subject to appropriate prudential regulation here and abroad that those limits which they were imposing were unreasonable, that the regulators had got it wrong and therefore this was a market failure that required correction or was the simple analysis that the shutters had gone up and therefore that meant that they were in the market gap and you could provide assistance, albeit it in markets which may be more problematic? Sorry, Mr Armour, a nod isn't recorded.

MR ARMOUR (EFIC): I'm trying to think through your question. Could you repeat that question as it's a complex one.

DR MUNDY: You're saying that this firm in question, obviously a major firm, was up against its limits, limits set by organisations which are properly prudentially managed. So you're saying that in those circumstances it is proper for you to provide assistance.

MR ARMOUR (EFIC): The underlying assumption I think you're making there, commissioner, is that even these institutions operating within their limits - I don't necessarily know if they were prudential limits, that's why I paused for a second, these may have been internal and it's not necessarily proposed by regulators. They had limits.

DR MUNDY: Obviously profits are regulated.

MR ARMOUR (EFIC): They had limits. Exactly. Let's just say they have limits. Normal market participants with limits, had reached those limits and, therefore, was our activity legitimately in the market gap? Our assessment was this: firstly, that the market itself may not have been large enough to serve what was required by the firm. So in some of these products you have to be again conscious that money doesn't flow from one product to another necessarily quickly and secondly, that we would price to make sure that, again, our return relative to the market in the individual transaction was appropriate. On that basis we felt this was legitimate activity for market gap. It may not meet your hard and fast rule of market failure but from our perspective there is a bit of a failure because we believe - and this is where we are at odds fundamentally - is that the markets themselves are inefficient.

DR MUNDY: I think we accept markets are inefficient but that's fine, that answers my question. In the submission we received from Wiggins Island Coal Export Terminal they indicated to us that your assistance was necessary because otherwise the project could not proceed at that time and part of the issue was a deadline that was set by the Queensland government and that's what the submission says. I guess that begs the question, what would be the consequence if you hadn't intervened and let's assume the reasonably established policy position of the Queensland government had have taken its course. Was that a matter that you would have given consideration to?

MR ARMOUR (EFIC): From EFIC's perspective in terms of whether it made its decision that there was a market gap?

DR MUNDY: I guess what I'm driving at is here we have a circumstance where EFIC has provided assistance, we are told because of a time frame established by an Australian government presumably acting lawfully and that this has constituted a market gap.

MR ARMOUR (EFIC): I think there's a broader context than just the Queensland regulation. I mean, there are commercial considerations, there is - - -

DR MUNDY: I'm going to Wiggins' evidence to us, particularly about the urgency of completing this transaction, and they say it would not have occurred at that time.

MR ARMOUR (EFIC): They may have had to reapply for whatever permits or authorisations may have lapsed. But I think the more germane point is the fact that this facility took a long time to complete. In fact they allowed themselves what they thought was ample or abundant amount of time to get it completed in the commercial and they failed to do that. They got to a point at which there was no more capacity for this particular credit.

DR MUNDY: Is it your opinion they allowed themselves a reasonable time or may they have been overambitious?

MR ARMOUR (EFIC): I don't think it's a question of being overambitious. I think that they ran out of credit capacity.

MS SCOTT: In its letter of expectations it requires EFIC to assess whether it's competing with private sector providers and it examines information which shows that EFIC is not competing directly with existing commercial sector providers and must be included in any board paper seeking approval for a transaction. We've got an example of documentation that goes to the board but how do you actually make this assessment? I want to come back to what questions you ask of the client, what questions you ask of their providers, how you ascertain that they are genuinely in the market gap.

MR ARMOUR (EFIC): I'm just trying to make these answers short but it's a struggle. It really does depend on the circumstance. There are overseas markets, for example, where we can be fairly confident almost immediately that the Australian banking system is not actively engaged. So then the question is whether - and we play a supplemental role of whether commercial capacity from overseas banks can provide the support that's needed. So that's one dimension, if you like. Sorry, commissioner, I lost my train of thought with that little useful interlude.

MS SCOTT: Can we have our phones on silent please? Thank you very much. Sorry, back to you. So if it's emerging or frontier markets you sort of know that it's, you know, Upper Zambia - - -

MR ARMOUR (EFIC): We know the Australian banking system isn't involved. That doesn't mean we don't inquire further about what commercial capacity is available, because the statement of expectations is not limited to Australian banking capacity that I'm conscious of; certainly that's not how we react to it. If it's a project that arguably would have Australian interest and we inquire both of the client and of the banking sector generally - you have to appreciate that our staff come from the banking sector, we have deep relationships with the project finance and syndicated loan desks and the export finance teams at all the major institutions. You would have seen that, frankly, from the submissions, that globally we have a very deep knowledge of how the markets are providing support. So we test it. We don't take it at first blush that if someone represents they're having a struggle that they're having a struggle.

MS SCOTT: So that would be phone calls, emails, things like that?

MR ARMOUR (EFIC): Exactly.

MS SCOTT: You do that in each instance even if there's - you know, one comes in on Tuesday, another one comes in on Thursday, you would still go through the process of ensuring that you've checked each time?

MR ARMOUR (EFIC): It's very unusual they would be homogenous, even if they came in two days apart.

MS SCOTT: That's right. You'd be checking each time?

MR ARMOUR (EFIC): Yes.

MS SCOTT: Is there any written material provided to the board on what's in the board paper? Would that be typical or not?

MR ARMOUR (EFIC): On individual banks? No, the material that's captured and summarised for the board has been provided to you.

MS SCOTT: Effectively the board has the paper, it has this short segment on market gap, you're ready to answer questions and you've got what you consider to be a well-informed board that can engage in a discussion on that as necessary?

MR ARMOUR (EFIC): I think there's a step further, commissioner, but I don't know if you want to hear it. It's, in the end, res ipsa loquitur. That is, if you're looking at all of the reviews of EFIC since I joined in 1993, if you look at the submissions to this review, I think you see a very consistent message that the market does not perceive EFIC to be competing in any way with private capital.

MS SCOTT: Yes, but what I'm trying to check is how - you don't have the advantage. I mean, proposals come forward, your desks have got in touch with the banks, you've got in touch with overseas desks, you don't have the advantage of submissions coming into our inquiry or inquiries every five years; or are you saying, "No, I take comfort from the 2006 review and I know now that we're definitely in the market gap and if this proposal comes forward I feel confident that it's probably in my waters, in the market gap." I'm trying to establish what - - -

MR ARMOUR (EFIC): Yes, and, commissioner, my blunt response to that would be I take no comfort from a bureaucratic process if it can't be demonstrated later that we were successful. The argument I'm making is there is an inference, there is an implication in your remarks that our process should have more bureaucracy associated with it. I think, quite frankly, it relies on our ability to reach the market in a comprehensive way and in some depth, and the experience of the past 20 years shows that we do that.

MS SCOTT: I'm just trying to work out what lies behind - you know, the summary is brief, you've made that clear, but lying behind that there would be a body of papers that would go to the fact that, "So-and-so rang X, Y, Z, rang a number of institutions, checked it out with international players, came back and engaged with the client again and their bank and established, no, that's it, they're in the market gap." There would be a body of paper behind the summary here.

MR ARMOUR (EFIC): It's not always evidenced by paper, commissioner. It can be conversations, and then the conversations are summarised in what we provide in our credit memo and in the board paper.

MS SCOTT: My colleague is probably telling me I need to wrap up because we've got more questions. I'll just check. No, I get to have a go, I get to keep going. Well, just before I move on - I want to change topic soon but I just want to - you've got experienced staff, know what they're doing, informed board, not a lot is necessarily documented but they get a succinct summary in a board paper and typically there would be an extensive discussion in a board about this?

MR ARMOUR (EFIC): Depending on the circumstances, yes, it could go for - - -

MS SCOTT: Well, it might not be.

MR ARMOUR (EFIC): It could be five minutes, it could be half an hour, it really just depends. If it's PNG the conversation is going to be probably abbreviated relative to a more stable market; that's not a good diplomatic term, but - - -

MS SCOTT: Okay. We focused on your interest in onshore ventures, but you are recommending increased flexibility to undertake increased support for offshore operations by Australian firms. What support are you currently restrained in providing that you would like to provide?

MR ARMOUR (EFIC): I'm sorry, commissioner, I was distracted. Could you just repeat that?

MS SCOTT: We have focused on your increasing interest in onshore ventures, but you are recommending increased flexibility to undertake increased support for offshore operations by Australian firms. What support are you currently restrained in providing that you would like to provide?

MR ARMOUR (EFIC): Commissioner, I think this question relates to the material we provided for the 2006 review, is that correct, in that what was adopted by successive governments as policy but not legislated. In 2006 we said to government that - as part of structural change that particularly - - -

MS SCOTT: I'm familiar with that - - -

MR ARMOUR (EFIC): Am I right?

MS SCOTT: Yes, look, I'm familiar with that material. I'm just trying to work out what you're currently restrained in providing because your organisation has got quite considerable flexibility in some areas. I'm trying to work out what you're currently restrained in providing because the legislation hasn't - - -

MR ARMOUR (EFIC): Then the briefest answer would be a legislated mandate to support SME supply chains. That's not clear in our functions right now. We think it would be worthwhile to make that clear if not in our functions at least in the next speech that introduces the EFIC legislation to say that this is an appropriate purpose.

MS SCOTT: So you can help in domestic supply chains but not in overseas supply chains?

MR ARMOUR (EFIC): We have some capacity to help overseas but it is restricted by the product that we can offer. We think there is a broader issue in terms of all of government policy moving in support of structural change for Australian firms. We just think this would be an appropriate and cohesive way of reflecting it.

MS SCOTT: You've tested obviously your onshore capacity with that - you know, looking at storage facilities for exporters, you went off to AGS on that matter. Have you gone off to AGS in relation to the supply chain offshore?

MR ARMOUR (EFIC): We certainly have advice, commissioner. I can't tell you precisely when and from whom but we have - - -

MS SCOTT: But you have sought legal advice on that?

MR ARMOUR (EFIC): Yes.

MS SCOTT: You feel constrained by that?

MR ARMOUR (EFIC): Correct.

MS SCOTT: Okay.

MR ARMOUR (EFIC): Sorry, commissioner, beyond that, the fact that government announced policy but then it wasn't legislated. I think it's incomplete at this point. So they've said they intend to go in this direction but they just haven't legislated this direction.

MS SCOTT: You haven't acted on their word. You've waited for the legislation?

MR ARMOUR (EFIC): Well, we are acting within our legislation. We must act within our legislation.

MS SCOTT: No, so yes or no, you're not going on what they've said, you're waiting for legislation?

MR ARMOUR (EFIC): There are some aspects that we can provide within our current legislation, which I have said we are doing, but that's not the whole proposition that we put to government and which they'd agreed so, no. You know, if you say are we doing everything that we put forward, no, because we can't in the legislation.

DR MUNDY: Has Minister Emerson reaffirmed the government's policy position to you since he became minister?

MR ARMOUR (EFIC): When he became minister he indicated that he wanted to have this review before he formed a view on this policy.

DR MUNDY: So the veracity of the claim that it's government policy needs to be tempered by that observation?

MR ARMOUR (EFIC): Correct. The previous trade minister endorsed it, the previous government endorsed it, but not the current trade minister. Neither did he reject the previous policy, in this respect, but he said he would not go forward until you finished your review.

DR MUNDY: I understand, thank you.

MS SCOTT: You've helped firms establish, effectively, part of their supply chains offshore within the existing flexibility, as you see it?

MR ARMOUR (EFIC): It has been fairly limited, commissioner, at this point because until that legislation is introduced we feel uncomfortable promoting this capability too broadly.

MS SCOTT: So you haven't promoted it but you can still do it?

MR ARMOUR (EFIC): In a limited, narrow way.

MS SCOTT: So what's the limit and the narrow? Can you explain what they are?

MR ARMOUR (EFIC): Sure. Practically speaking it's around the product, and that is, we cannot do any direct lending in relation to supply chains. Practically speaking as well - again, we are simply not promoting it. So if you go to our web site we talk about how we can help you to export, we talk about how we help you invest, we don't actually go out and articulate, "We can help you to maintain your supply chain."

MS SCOTT: If the recommendation as we see it got up and got into legislation, you'd then be able to promote this activity, you'd be able to get into direct lending and you'd be able to assist firms in their offshore ventures.

MR ARMOUR (EFIC): Correct.

MS SCOTT: Including moving offshore?

MR ARMOUR (EFIC): The original formulation, not endorsed by the current minister, was restricted. That is, there were a number of aspects of the tests that were to be applied to this initiative, which I think you have that information available to you, so it was around what are the benefits.

MS SCOTT: Yes.

MR ARMOUR (EFIC): There was also a no net job loss test for Australia.

MS SCOTT: Okay.

MR ARMOUR (EFIC): Again, I don't know if the current minister would agree with that, practically or not. I don't know.

DR MUNDY: Mr Armour, you'll be aware of media reporting in the Tasmanian media, I think it was, on the weekend about some Gunns transaction, a suggestion you may be involved in a pulp - no, I think it's at Bell Bay. Can you, for the record, tell us what EFIC's involvement with this proposal has been?

MR ARMOUR (EFIC): Sure, I'm happy to repeat for the record here, as I have in Senate Estimates, which is Gunns had approached EFIC over two years ago. We had a series of conversations over that year; and by series, I mean four, maybe five over the period of a year. Obviously they have many steps to take before they're in a position to start considering their debt, and we're not in any serious review of the project at this point. So there certainly have been conversations but I think the report in the Tasmanian Mercury was as much a surprise to me as it was to you.

DR MUNDY: So there has been no discussions between yourself or other officers of EFIC and government departments and ministers' offices?

MR ARMOUR (EFIC): Government departments and ministers would be aware of this, I believe. I would need to reflect on precisely when - certainly our minister and his predecessor were very much aware that we had been approached on this. We have made it a point of putting it in some of our written correspondence and featured in the conversations. I expect it would be of - but this is only my estimation - I expect it's more broadly known within government that we have been approached because of the sensitivity - I think I can use that word legitimately - the sensitivity around this development, we wanted to make sure the government was aware from the very start that we'd been approached.

DR MUNDY: But these are obviously not recent conversations?

MR ARMOUR (EFIC): No. Well, we haven't had a recent conversation.

DR MUNDY: You've had no discussions with other persons - the Tasmanian government's - - -

MR ARMOUR (EFIC): You mean recently?

DR MUNDY: Yes.

MR ARMOUR (EFIC): No.

DR MUNDY: Forestry lobby groups, the unions - - -

MR ARMOUR (EFIC): Honestly, in the past year I don't think I've spoken to a Gunns' person.

DR MUNDY: I mean, it was interesting that the media report suggested that there was a cabinet paper circulating which would, at least a priori, suggest it may have been a consideration of the National Interest Account. Was that the nature of the discussions you had with Gunns or was it your - was your discussions around you doing it on the commercial account?

MR ARMOUR (EFIC): It's an excellent point. When we were talking to government we said, "This is something that if we couldn't do it on the commercial account we'd really struggle to see how we could put this forward." So the fact that it emerged on the national interest through - sorry, the fact that it was reported as a cabinet discussion around national interest was very much a surprise to us.

DR MUNDY: So you're not aware of any cabinet process that's being instigated?

MR ARMOUR (EFIC): We were not involved in any conversations at all.

DR MUNDY: Okay, thank you.

MS SCOTT: In your supplementary submission you state that, "EFIC has access to broader information sources than private sector participants." What are the sources that you have that others in the market cannot access?

MR ARMOUR (EFIC): My Chief Economist is probably better informed than I on this issue but I'll characterise broadly. Most of that information would be official sources. So what are official sources? Like, the World Bank and the IMF will publish for public consumption - are abridged vis-a-vis what the full extent of their knowledge would be. We have access to a greater depth of reporting, and we have, by virtue of our ownership, I think, greater access to individuals and to conversations with individuals within those institutions to understand the environment that we're working in.

MS SCOTT: So it relates to IMF and the World Bank only?

MR ARMOUR (EFIC): I'm talking about official institutions, European Bank for Reconstruction and Development, any sort of - you can think of cross-ownership, so where an Australian government has ownership of an institution there is probably a deeper relationship.

DR MUNDY: That information, you say, is primarily oral?

MR ARMOUR (EFIC): No, some of that would be in writing definitely, but not for public consumption.

DR MUNDY: So my recollection is that the Treasury has principal carriage in relation to the World Bank and the IMF. Does this additional information come to you via the Treasury or does it come to you via DFAT?

MR ARMOUR (EFIC): No, not necessarily, no.

DR MUNDY: So how else?

MR ARMOUR (EFIC): Quite frankly, it could be direct. So when I visit Washington I will contact normally the executive director of the bank and say, "I'd like to see these people - - -"

DR MUNDY: So it's not coming to you via other government agencies?

MR ARMOUR (EFIC): No, not normally. Sorry, not that I'm aware of. Can I just verify that for you. I think it's correct.

DR MUNDY: No, that's fine.

MS SCOTT: That's fine. Have you been told by the government to concentrate your activity in certain niche markets?

MR ARMOUR (EFIC): No, commissioner, not that I'm conscious of.

MS SCOTT: The reason why I refer to that is that on page 48 of your supplementary submission you say that you operate in niche markets and this affects then more your rate of return. But effectively that's a choice that EFIC makes, it's not something that the government dictates to you?

MR ARMOUR (EFIC): Sorry, I misinterpreted what you were saying. I thought niche markets you meant particular geographies. No, niche market in the context of what we were writing there, means our restricted mandate around a handful of products working in a particular risk spectrum in the market.

MS SCOTT: But does it mean that you have to operate in particular industries? It doesn't mean you have to operate, you know, particularly Sri Lanka or anything like that?

MR ARMOUR (EFIC): We do have restrictions on industries, if you look at the tests in relation to some of the products.

MS SCOTT: Yes, something very small, and then you've got uranium. I mean - - -

MR ARMOUR (EFIC): No, capital goods, for example.

MS SCOTT: Yes.

MR ARMOUR (EFIC): Capital goods for some products.

MS SCOTT: Yes, but in terms of this - anyway, all right, you've defined what you consider "niche" to be. On page 68 of your submission you list a number of areas where ECAs are increasingly supporting water desalination plants, wind farms, special equipment for pulp mills. Can you explain why ECAs are increasingly in this space, and also your sentence that, "ECA financing" - this is going back to your material - "is dominating the composition of financing syndicates in relation to these things." So why are ECAs increasingly into water desalination plants, wind farms and special equipment for pulp mills?

MR ARMOUR (EFIC): That would very much reflect the - I haven't opened to the page, but I'll give my impression from the industry. So when it comes to wind farms, for example, there are a number of ECAs who have a particular focus on this industry, because they are world leaders in their production. In the same way that you have been critical of us doing shipbuilding, if you look at the Danish agencies, for example, they do a great deal in wind farms because the Danes are a natural competitor in this space and, by extension, those other sectors that are identified there.

MS SCOTT: So there will be an ECA that has a particular interest in water desalination plants, another one that has got a special interest in or special equipment for pulp mills.

MR ARMOUR (EFIC): Well, plural, but, yes, agencies.

MS SCOTT: Has EFIC supported these types of projects either here or abroad: wind farms, water desalination projects, or pulp mills?

MR ARMOUR (EFIC): No, water purification but not desalination.

MS SCOTT: Okay.

MR ARMOUR (EFIC): And there are no wind farm manufacturers, I think, left in Australia.

MS SCOTT: In your submission to us you expressed no view about whether there be any issues about removing the government member; you know, we have made recommendation that the government member should be removed from your board. I have to say there has been little objection to it. What sort of changes to your governance and reporting arrangements would be required if the government accepted our recommendation?

MR ARMOUR (EFIC): That's a very difficult question, commissioner. I think that in the context of what government would require from us in that event, it is a matter of policy. It was an Uhrig policy choice by government not to implement Uhrig when it came to EFIC. It was not, obviously, an EFIC matter. I expect the basis on which we provide reporting would have to change in some way. It might be frequency, it might be depth. It might in fact be less depth rather than more. We would really need to ascertain what the minister's needs and obligations were under a new regime.

DR MUNDY: In 2010 your auditors noted some relatively large exposures on the commercial account and suggested or recommended - I suppose either works - that there be some stress testing and scenario analysis undertaken towards country and industry-specific risk. When was that stress testing?

MR ARMOUR (EFIC): We actually had been doing stress testing for the past few years, so their observation, I think, was in relation to particular markets or particular exposures.

DR MUNDY: Yes.

MR ARMOUR (EFIC): So if you have - - -

DR MUNDY: I'm interested in the stress testing that they felt needed to be done. I accept you might have been doing it otherwise.

MR ARMOUR (EFIC): Okay, that's fine. John, can you join me and just talk a bit more about the detail there.

MR PACEY (EFIC): John Pacey, Chief Credit Officer, EFIC.

DR MUNDY: Yes.

MR PACEY (EFIC): The suggestion was that we - that as a further enhancement we could do further stress testing on our portfolio for particular industries. Our approach has been, we do sensitivity analysis on the portfolio in relation to risk ratings, in particular in relation to the shipping industry. We have discussed with the board - in sessions we have with the board - our exposure in certain scenarios. That has been the bulk of our approach.

DR MUNDY: Okay, sorry, you may not have quite caught the exact question. I am specifically interested in when you undertook the activities that were of concern specifically to your auditors in 2010.

MR PACEY (EFIC): Well, it wasn't said it was of a concern. It was said as an area of improvement you could consider additional stress testing in relation to certain industries.

DR MUNDY: Have you made any changes to your risk management practices as a result of recommendations, expressions or findings of internal audit reports?

MR PACEY (EFIC): Well, we have.

DR MUNDY: Can you give me some examples?

MR PACEY (EFIC): From that same report or maybe it was the previous year - I would have to check - to ensure full compliance with some of the APRA guidelines, our procedures could cross-reference other procedures better. We certainly implemented that change. Last year there were some recommendations around reporting in relation to problem assets, in terms of the nature of those reports and we have implemented those changes this year.

DR MUNDY: When you make these changes, do you then go back? Does the internal auditor come back and have another look at them or do you liaise with them about, is that adequate to address their concerns. Is that your normal practice?

MR PACEY (EFIC): Yes, we have an annual audit - we're going through one at the present time - and there is a particular component of that audit that is just focused on credit and the credit-decision making process.

MR ARMOUR (EFIC): Sorry, and they always revisit previous findings to make sure that we've - - -

DR MUNDY: Yes. In your response to us, we had some issues around language about risk-participation agreements, Mr Armour. I think there was a question of whether risk-participation agreements should be treated as described as guarantees or insurance. This is a linguistic issue, Mr Armour. What I actually would like to do is just give you the question in writing and ask if you could just respond to it properly. That would be easier, I think, than us having a discussion about - but just for the record, we pass that over.

MR ARMOUR (EFIC): Close of business tomorrow?

DR MUNDY: Close of business tomorrow, thank you.

MS SCOTT: Look, I referred earlier, Angus, to this issue of submissions made to us saying - I'm paraphrasing - that the involvement of EFIC means that a project that we might not have been interested in or might only have been marginally interested in, now that EFIC is involved we will commit more funds to it, and you thought that was only in relation to overseas banks. But the Commonwealth Bank of Australia - if the technology helps me I'll be able to read it out to you - - -

MR ARMOUR (EFIC): Sorry, commissioner, overseas markets not overseas banks.

MS SCOTT: Okay. Overseas markets. So the Commonwealth Bank of Australia said, "Providing a credit enhancement or wrap for very large developments. Whilst EFIC cannot directly lend in all circumstances to the borrower, it 'guarantees' a portion of the obligations of the borrower. As the recourse of the lender is now partially to EFIC, rather than to the borrower directly, this allows a lender (or group of lenders) to provide a larger volume of debt to a project. Typically, the majority of the debt is lent to the borrower directly, with the EFIC 'guaranteed' tranche allowing lenders to provide additional debt capital." Citibank has said - - -

MR ARMOUR (EFIC): Commissioner, we could give you an example of that.

MS SCOTT: I'm sure if I had more time I would be able to find a quote, probably, from each of the - it's basically saying, "EFIC is a good crowd and when they're involved in a project, we'll be more interested in the project." That comes back now to my question to you: how do you know that when you're supporting project A and that therefore attracts more domestic support from our banks - banks located here - that doesn't then therefore that there is less funds domestically - and it could be offshore - less funds available to export project B that didn't approach you.

MR ARMOUR (EFIC): Commissioner, I believe I understand your concern. The quote that you have read out from CBA, I would like to say, is directly representative of WICET. So if you look at the WICET case study of how we participated in testing the market, making sure there was a shortfall et cetera, I think is directly relevant to the CBA quote, and this is the important point I'm trying to distinguish between what we do overseas versus what we do here. So we're focused here, we're talking about domestic market, we're talking about what the Australia banking system is willing to do. If you look at, you know, the very few cases that we've been involved in, the banks have tended - well, not tended - have delivered capacity up to their normal limits. That has proved to be insufficient.

You see that in the projects we're involved in, export credit agencies as a class represent somewhere between 25 per cent or 50 per cent of the debt involved. In the project most recently concluded for APLNG it was as much as 75 per cent. I think the point that CBA's submission is seeking to make is that we can help, through our guarantee, provide additional debt capacity as required for the project as a whole. The bank itself will, sensibly, within Australia, have its own risk assessment and say, "This is the amount of money we're willing to lend, up to this limit but the banking sector capacity, let's say, tops out at two billion, and the project is six or eight or ten." What has happened in recent years has been an inflow of export credit agency money to fill out the balance that is required.

MS SCOTT: Thank you for that. But the point I'm trying to ascertain is: you refer to your activities crowding in private money, but if your activity means that an extra domestic dollar - whether it is sourced entirely domestically or actually comes through offshore borrowings, it doesn't really matter - if it in fact goes to project A and therefore doesn't go to project B, how do you know that you're crowding in activity in the export sector? You could actually be just simply transferring activity from one exporter to another exporter, just the difference being that one exporter might have got up on commercial terms in a commercial way, whereas your player has got up because they were seen as being in the market gap. I mean, money is fungible and, I guess, at the end of the day it is always going to be scarce. How do you know that you are into additionality of activity? You could simply be taking activity from firm B to firm A.

MR ARMOUR (EFIC): Commissioner, I think there are a couple of areas where we need to address your concerns, and one I know you're deeply unhappy about and that is, money is not fungible. That's the purpose of saying that markets are imperfect. Money will not flow quickly from one product line to another product line in a bank. So the whole concept that money sloshes around like water in a bathtub is inappropriate to financial market - - -

DR MUNDY: I don't think, with respect, Mr Armour, we have ever suggested that.

MR ARMOUR (EFIC): But it is what I'm inferring from your remarks.

DR MUNDY: Can I suggest that your inferences are incorrect.

MR ARMOUR (EFIC): Okay, I can accept that. But I am concerned, because this is very much - - -

DR MUNDY: And we're concerned that perhaps in some of the representations of what we've said, that you have been making these representations, which I am glad you now admit are not what we have been seeking to do.

MR ARMOUR (EFIC): I'm sorry, I don't admit that. I'm saying that if I have misinterpreted you, I apologise. But this is how a reasonable person would interpret what you're saying.

MS SCOTT: Even if you object to the word fungible, I will make it easier for you, working within your framework, how can you be confident that project A, now receiving additional support from banks, has not been as a result of less funds being available to an export project B that didn't approach EFIC? I think the answer is going to have to be, you can't be confident. But if you can be confident, I would like you to tell me how you are confident.

MR ARMOUR (EFIC): Which is your second conceptual point, from my perspective, commissioner - and correct me again if I'm wrong, but it is that issue of diversion. If by participating are we diverting or distorting the economy by having one project supported over another. I do want to make sure that we're clear in the record here that you have used project and exporter interchangeably. I think your concern is really around the big projects again. If that's - - -

MS SCOTT: Not necessarily, but I would be interested in - if you wish to make it easier for your analysis to be at the large project stage, that's fine. But I am interested in ascertaining why you can be confident that you're not seeing a diversion of funds and that you are - quote, your words - "crowding in" activity at no expense to other projects in the economy.

MR ARMOUR (EFIC): The simplest and most direct answer to that would be, stepping back and looking at the banking system as a whole, you will see that banks at this stage in the credit cycle are actually seeking to grow their top-line revenue. The best evidence of that, commissioner, is the fact that you are seeing their limits in relation to these large projects, from my perspective, increase markedly over the past two years.

MS SCOTT: Yes, that's right; that's true.

MR ARMOUR (EFIC): So they have commercially said - - -

MS SCOTT: The market gap, your concept, is clearly diminishing.

MR ARMOUR (EFIC): Ideally.

MS SCOTT: Yes.

MR ARMOUR (EFIC): Absolutely.

MS SCOTT: But whether it is market gap today or tomorrow, at any point in time - so at a point in time, how can you be confident that your crowding in of activity, your words, has not been a diversion from one project to another? I'm still just after, "This is how I know." If you could start your response that way, that would help me, because that is what I am trying to narrow your response to.

MR ARMOUR (EFIC): I know that capacity across the economy is now constrained. I know that banks have additional lending capacity that they could deploy. I know that from the evidence of them increasing their limits. I know that from the evidence of the large facilities they have put in place for these projects. I surmise from that that our additional participation at the margin - and you have to remember it is at the margin, a point you make in your report, I believe - is helping to close on a particular project, but not at the expense of other projects.

MS SCOTT: So I can take it there are in fact no fixed limits operating at any point in time.

MR ARMOUR (EFIC): I'm sorry, I don't understand.

DR MUNDY: At least there is no aggregate constraint on the availability of capital for these projects or in the economy more generally.

MS SCOTT: That is what you're saying?

MR ARMOUR (EFIC): No, I'm saying that banks are constrained by their APRA regulations and their limits, but they are not constrained from supporting 30 projects. I infer from your remark that you're concerned that there are, you know, five projects and only two will go. I am saying there could be 10 projects and all could go, and even all could go at bigger limits than you might have seen two years ago. But it is still not sufficient, given the volume of debt that is required.

DR MUNDY: We will reflect upon what you've said.

MR ARMOUR (EFIC): Did I answer that question?

MS SCOTT: I doubt it, but we will come back to it if it's - - -

MR ARMOUR (EFIC): I am trying.

DR MUNDY: I would just like now to turn to the question of pricing generally, but in particular the levels of return that you seek to earn from individual transactions. Bearing in mind that your pricing decisions will in part reflect risk, is there a minimum hurdle rate, presumably for a relatively low-risk process, below which you just won't proceed?

MR ARMOUR (EFIC): Yes.

DR MUNDY: What is that rate, Mr Armour?

MR ARMOUR (EFIC): I would say it's about 8 per cent.

DR MUNDY: It's about eight.

MR ARMOUR (EFIC): It would depend, frankly, on what is driving that outcome. I mean, I am going to have to look back over the past two or three years and see whether anything has come below that.

DR MUNDY: No. But I'm happy to take 8 per cent. Now, can I just tease that out a little bit, because obviously if bond rates are 6 per cent or bond rates are 3 per cent, your view might be different. Is that 8 per cent off a bond rate of around about 4 and a half, 5. Is that what we're talking about?

MR ARMOUR (EFIC): Frankly, commissioner, our hurdle expectation relates more to what we think we have established with government through the corporate plan process. So we put forward a corporate plan and we say, "Here are the outcomes, including our return."

DR MUNDY: Yes.

MR ARMOUR (EFIC): "Is this acceptable to you?" The minister receives it, writes back, and says, "Yes, that's acceptable to me." We go through this with Finance and Treasury, they say, "Yes, that's acceptable to us." We feel that as long as we're working within the parameters that we have described in the corporate plan, that we are achieving what the government has asked us to do. So that is how we come back to the return argument. Individual transactions may vary, but we look at the portfolio.

DR MUNDY: But what I'm trying to tease out, is it from relatively low-risk transactions, assessed by yourself, accepting they all have some risk to them, around about eight per cent is the level that you would not go below?

MR ARMOUR (EFIC): No. From relatively low transactions, from my memory right now, we are making somewhere between 22 and 30 per cent.

DR MUNDY: Yes. But if you were presented with a proposition - that was not the question I asked you, with respect. The question is, is there a hurdle below which you will not go?

MR ARMOUR (EFIC): Yes, for a high-risk transaction, below 8 I would think, "Why are we doing this?"

DR MUNDY: Yes.

MR ARMOUR (EFIC): I'm not saying I would say no.

DR MUNDY: I'm not saying you wouldn't necessarily do it at 8.

MR ARMOUR (EFIC): Exactly. But for a low-risk transaction I would say, "We expect to make a lot of money," because that's the only way you're going to crowd in the private market and push them into the market eventually.

DR MUNDY: Okay.

MS SCOTT: In relation to matters on commercial account, are there other non-financial indicators or considerations that are given weight by the board by assessing a transaction, for example, local content, regional development, cultural enrichment, something like that?

MR ARMOUR (EFIC): No.

MS SCOTT: No? That's fine. In relation to your submission and your evidence to us you indicated that EFIC is a price-taker. Do you take that to mean that you receive the same price as the private sector would for a comparable level of risk?

MR ARMOUR (EFIC): Yes.

MS SCOTT: You've previously stated that the private sector is unwilling to take on the transactions, therefore it's in the market gap. So why is it that EFIC is able to take it on, the transaction at the price, when the private sector can't?

MR ARMOUR (EFIC): The reason I hesitated the first time is obviously there are times we're looking at a price. For example, in an African market where there aren't many benchmarks, so we basically have to extrapolate from the neighbourhood, and that type of risk dimension. So there is a price that I think is reasonable based on comparable risk but is not actually representative of what's happening in the market because there's nothing happening in that market.

MS SCOTT: Well, let's go with a more established market, for example, when you support a firm that's dealing in a more well-established economy. You're able to take on the activity and you price take, although you're operating in a gap and there isn't actually anyone providing the transaction that you're going to get into. Are you able to get into it because you effectively have lower costs or is it because you're taking on uncompensated risk, in this case?

MR ARMOUR (EFIC): Commissioner, I don't agree with the first premise, which is there is no capacity, sometimes it's simply an insufficient capacity. That would certainly apply to our SME portfolio and what we're doing there and will often apply to our offshore work as well. So it's not that there is no capacity. It might simply be for a small firm dealing with one bank who don't have as many financing options it may be insufficient capacity.

MS SCOTT: Some submissions have mentioned the benefit derived from the Australian government guarantee, in effect, as they see it. Citi, for example, noted that a key difference between EFIC and the private sector is that EFIC's status as an entity enjoying "the full faith and credit of the Australian sovereign government" and that this risk enhancement enables private sector players to be more interested in the project as a result. Is EFIC able to charge its clients for the benefit that is perceived to derive from the special status of EFIC, the implied guarantee or the actual guarantee?

MR ARMOUR (EFIC): No. Again, the price we take relates to the risk that we believe we're assuming. The private sector may implicitly acknowledge the fact that we're an AAA institution, may provide capacity on that basis. There are many different transactions structures but let's say arguably - we price for risk. If our involvement helps to - this phrase you don't like - "crowd in" their involvement, that's a benefit, from our perspective. It is practically proven to be useful in some circumstances.

MS SCOTT: But you don't price for that benefit?

MR ARMOUR (EFIC): No, we price to risk.

MS SCOTT: You said that you're not subsidising your transactions. Therefore I take it that you think that you're covering the full economic costs of the transaction?

MR ARMOUR (EFIC): I believe so. I might ask one of my economists to come up at this point. I have a feeling you will go into some sort of economic argument I'm unable to answer.

MR DONNELLY (EFIC): Yes, hello, Roger Donnelly, Chief Economist.

MS SCOTT: Okay. Roger, EFIC has indicated a number of times that they do not consider they're providing a subsidy to their clients. Now, we could take it that that then means that you are reflecting the full economic cost of your transactions to your customers. Is that a reasonable interpretation of what you're saying?

MR DONNELLY (EFIC): I think it is, commissioner, although I suppose we could get into some debate about what the appropriate return on our capital is that we have to allocate to a transaction. There is no definitive answer to that question, but yes, we think we are receiving proper compensation for our capital as well as covering our other costs.

DR MUNDY: Sorry, your capital or the government's capital?

MR DONNELLY (EFIC): The capital that the government has invested in EFIC.

MS SCOTT: We had a recommendation, 8.3 in our report, which said the commission recommended that EFIC's pricing of Commercial Account transactions should reflect their full economic cost "including a commercial rate of return reflecting risk" - don't think you're going to have any objection to - "that is benchmarked against that of appropriately selected private sector providers". Now, you've indicated sometimes it's hard to find but sometimes it's not impossible. EFIC has stated that this recommendation is not substantiated, impractical, conflicting or unnecessary. So I'm just trying to work out what bit of not covering full economic cost provision you have trouble with?

MR ARMOUR (EFIC): Well, you maybe know this section more but the - if I'm right about this section, maybe I'll need to go back to the section reference. The premise we've disagreed with is that our returns would be comparable to the Australian banking system.

MS SCOTT: No, we actually didn't ever say that. I know we've had lots of people tell us that we said that but that could be a good challenge for your staff members, if you wish, between now and tomorrow to tell us what page number we said any number of things that we're accused of saying. But we might leave that homework for the end of our presentation, if you like, to you. I don't think we ever actually said that, Angus. We never actually said you should achieve the rate of return of Australia's major banks.

DR MUNDY: We did note it was below. We did not make a suggestion that it should be the same as.

MR ARMOUR (EFIC): Again, I think a reasonable person reading that report would infer that you cite that outcome.

MS SCOTT: Well, I think - - -

DR MUNDY: That's certainly not what a number of reasonable people I know have suggested, but let's leave it at that. Let's abstract from the issue of how the level of return is determined. But other than that issue, you wouldn't take exception to the fact that you should price to reflect all those characteristics?

MR ARMOUR (EFIC): Sorry, just to enumerate them again, we price to risk.

DR MUNDY: Yes. You price to risk, you reflect all your costs, so how is that proposition unsubstantiated, how is it impractical, how does it conflict with other things, presumably, and why is it unnecessary? I'm happy to take them one at a time.

MR DONNELLY (EFIC): Commissioner, could you give us, I'm sorry, the page reference?

DR MUNDY: Your supplementary submission page 12 about our recommendation 8.3. We'll start with "unsubstantiated" and particularly the notion of how prices should be determined.

MR ARMOUR (EFIC): Well, the "unsubstantiated" from my perspective would be the lack of analysis of our pricing model. I think there were some inferences - there were some implications in the report about our pricing that we didn't feel were right.

MS SCOTT: Well, we actually used your pricing model.

MR ARMOUR (EFIC): With assumptions that you made, rather than the data we provided.

MS SCOTT: Well, we actually used it with some of the data that you provided. I'm looking to my colleague now just to make sure that I've got this right, and - - -

MR ARMOUR (EFIC): No, your paragraph is quite explicit.

MS SCOTT: - - - that in fact we arrive at, certainly for one project - - -

MR ARMOUR (EFIC): Based on your assumptions, that's what you said.

MS SCOTT: - - - a rate of return that would not be positive. Now, I'm just going to check. Let's come back to that. Let's go to your concern that draft recommendation 8.3 and finding 8.4 is not substantiated. Do you guys have an objection to pricing for cost?

MR ARMOUR (EFIC): No. No, we don't think that your comment about our pricing is correct, based on that paragraph. Again, commissioner, we can argue back and forth about how the report is read but clearly it is unclear enough for enough people that we are not the only people to have read it that you want us to achieve a bank rate of return.

MS SCOTT: Well, we might come back to that, if time allows.

DR MUNDY: We're talking about what the shareholder should expect in this recommendation in its full context. So you would accept that transactions on the commercial account should reflect their full economic cost?

MR ARMOUR (EFIC): As we've previously agreed the definition.

DR MUNDY: You would accept that it should include a commercial rate of return reflecting risk. I take that as yes, because that's what you've told us you do. I think we discussed last time the general question of benchmarking your level of return, and you indicated to us that it might be not appropriate to price at what a small regional trading bank, Bank of Adelaide, Bank of Queensland, would price at. But as a general proposition I don't recall that you actually said that benchmarking your level of return was problematic, depending how the benchmark was chosen?

MR ARMOUR (EFIC):   I think that's entirely the government's discretion, commissioner.

DR MUNDY: Okay.

MR ARMOUR (EFIC):   Sorry, the observation I would like to make is we believe that through this corporate planning process which involves consultations with Finance and Treasury, this is what we've agreed. This is what we're wrestling with.

DR MUNDY: I understand all that, Mr Armour, so let's accept that. So we're still trying to work out how recommendation 8.3 is not substantiated when you've actually agreed with every bit of it, other than perhaps benchmarking against other financial institutions. I actually think - I mean why isn't it necessary? Why shouldn't the minister expect that in his statement of expectations? Because it's unnecessary in the sense it's a recommendation of what the minister should do, so it's simply unnecessary, you should just go on as you choose?

MR ARMOUR (EFIC):   I think you're characterising our reply.

MS SCOTT: Okay. Mr Armour, you made the point that we have used some assumptions. It's true, we did use some assumptions, but I need to draw your attention to the fact that they related to drawdown. We then tested the results we got using different drawdowns, and they did not affect the results materially. We do say that in the report, in the detailed analysis in the report. So I guess my point is that we seem to be in agreement that there shouldn't be subsidies and there should be full economic costs. We certainly think that we have evidence that there are subsidies, and that's why we did this work using your model, and that we did arrive at results that are not consistent with real economic costs. I might now move then to - - -

MR ARMOUR (EFIC):   Well, I'd appreciate understanding that in a little more detail, because it's not our conclusion. I think if you look at the portfolio return - you may take a particular example - - -

MS SCOTT: On transaction, on some - - -

MR ARMOUR (EFIC):   On a transaction?

MS SCOTT: Well, you know, the idea was that you were not cross-subsidising. We'd asked questions about cross-subsidising and I think we - I haven't checked each of the testimonies and I haven't checked each of the things - however, re-read your supplementary submission only two days ago. But I understood that you were saying that you do not cross-subsidise.

MR ARMOUR (EFIC): But I also made clear this morning with the commissioner's previous question that there may be instances where we have a rate of return less than 8 per cent if we're in a high-risk market and there's a particularly compelling reason to go forward. So it's not necessarily a cross-subsidy, that's why I'm trying to wrestle with your issue.

DR MUNDY: So what you're saying is if you have a particularly high-risk transaction - - -

MR ARMOUR (EFIC): Or a high concentration.

DR MUNDY: Which of itself may constitute risk in a portfolio sense, I'm sure you'd agree?

MR ARMOUR (EFIC): Yes, absolutely.

DR MUNDY: So what you're saying that in the event that you have a high-risk transaction you would actually, as a decision-making criteria, be able to expect a lower - you would be going - - -

MS SCOTT: Lower than the 8 per cent, lower than the minimum return that you'd normally expect?

MR ARMOUR (EFIC): Not a decision criteria. I said earlier it could be an exception, that's the word you used, commissioner. I agree, that's the word, "exception". So if we have a series of projects in Sri Lanka and we put more capital against Sri Lanka because we've got a larger exposure there, that will, by necessity, drive down the portfolio return for our Sri Lankan exposure. I think you're aware of all this data, we've given - - -

DR MUNDY: No.

MS SCOTT: No.

MR ARMOUR (EFIC): Sorry - - -

MS SCOTT: Just a sec.

MR ARMOUR (EFIC): So we've discussed with you - - -

DR MUNDY: Sorry. My question went to you about "marginal" in an individual transaction.

MR ARMOUR (EFIC): Yes, that's right, and that's the question I'm trying to answer.

DR MUNDY: So what you're saying is you put more capital against let's say Sri Lanka, just as an example. So what you're saying is that having allocated more capital there, you would, at the margins, accept a lower return. Why, because the capital is there?

MR ARMOUR (EFIC): No. At the margin we may agree as an exception to take a lower return for the last project that we do.

MS SCOTT: Why?

DR MUNDY: Why?

MR ARMOUR (EFIC): Because we still think we are going to make money on a portfolio basis and we think the actual transaction pricing is appropriate. So again, coming back to our argument, which is are you pricing the market and are you on a portfolio basis returning, the answer is yes, across the EFIC portfolio.

MS SCOTT: We've asked about individual transactions, individual projects, are you cross-subsiding? Pretty certain that my recollection is that you said no and that you have a minimum rate of return - yes; that you price according to risk - yes; you accept full economic cost - yes. But now you're saying in relation to some individual transactions that you will not achieve a positive return or a return that is commensurate with the risk.

MR ARMOUR (EFIC): No, I don't think I've - I haven't meant to imply that we will not receive a positive return.

MS SCOTT: All right.

DR MUNDY: What if a transaction, when you looked at it on an expected basis, given that it may go backward et cetera, earned the bond rate?

MR ARMOUR (EFIC): Sorry?

DR MUNDY: Earned the bond rate.

MR ARMOUR (EFIC): Like 4 per cent?

DR MUNDY: Well, whatever the bond rate was on the day. Would you proceed on that basis?

MR ARMOUR (EFIC): Well, we don't normally compare against the bond rate, which would be, you know, risk free. For example, we would normally compare against our portfolio expectations, again given the corporate plan. So I don't - I've never had to - - -

DR MUNDY: So is your answer no? If someone came into your office and said, "CEO, we want you to approve this transaction. The expected return is 4 per cent," and you happen to know the bond rate today is 4 per cent, you'd say no?

MR ARMOUR (EFIC): So the Australian risk-free bond rate?

DR MUNDY: Yes.

MR ARMOUR (EFIC): Correct, yes.

DR MUNDY: Okay. So if it was 5 and the bond rate was 4? What I'm trying to get at, Mr Armour, is how can one be satisfied that the Commonwealth is receiving adequate compensation with the risk that it bears across EFIC's portfolio as a whole and in relation to specific risks associated with specific transactions, because to be quite frank with you, the evidence that has been produced to this inquiry to date and other evidence in the public domain makes it very difficult to draw that conclusion.

MR ARMOUR (EFIC): Look, commissioner, again the - our argument about return has been very simply that we price individual transactions to market, so we believe that we are delivering what the market would expect as a rate of return. If our return on equity is at odds with your expectations, it does not reflect our pricing, it does not reflect our costs, it certainly doesn't reflect our losses. It may reflect, I think in fact we argue it does reflect, our capital base. There are two elements to that. Firstly, we are asked to do a great deal with our capital base, that is, we need to provide significant limits against our capital base and we have to have a significant cushion. Commissioner, I understand the direction you're going. It very much goes back to your perception of our business model. If we had a robust, diverse business model like a bank, I would feel more comfortable with your line of questioning. The issue I have got is that we don't. We work in these niche markets; we are asked to work in a very narrow area in terms of our mandate, which is the market gap which is within certain products.

MS SCOTT: Okay. I think we have probably - - -

DR MUNDY: We need to move on.

MS SCOTT: Yes. Your costs. We included in our report that your costs have increased, especially in staff areas, that your operating expenses were up 58 per cent compared to 06-07, that your staff numbers were up by 22 per cent, that your staff costs were actually up 55 per cent. I'm particularly interested in why your staff costs are increasing so much more than your actual numbers of staff. Could you explain briefly what are the drivers here.

MR ARMOUR (EFIC): Yes. About the highest conceptual level is we're hiring more professional staff rather than administrative staff, so the average salary of our new staff is higher than it would have been for the previous distribution of our staff. It's that simple.

MS SCOTT: Are you concerned about the fact that your costs have gone up by 55 per cent.

MR ARMOUR (EFIC): I think your report notes that our costs per transaction and our cost per export supported has actually been decreasing. That’s in your report; I didn't calculate those numbers. So I think on balance, we are comfortable and the board is comfortable that these decisions have been approved.

DR MUNDY: Over the last few years, what has been the average rate of increase of staff currently on payroll.

MR ARMOUR (EFIC): I would have to come back to you with a precise answer.

DR MUNDY: If you could by close of business tomorrow, that would be great.

MS SCOTT: Given your view that you are charging full economic costs, why do you have a concern about moving to a competitive neutrality policy?

MR ARMOUR (EFIC): Commissioner, I think I'll turn to my economists on competitive neutrality help. But our issue with competitive neutrality is we're not sure what it would achieve, given the policy outcomes we achieve.

MS SCOTT: Okay, but other market players, you're in a gap - they're out there; you're in a gap. If you had competitive neutrality applied to you, why would that disadvantage you, because you're actually in the gap, in your mind. I mean, you can't lose your business, because you're in the gap.

MR ARMOUR (EFIC): It's not about the business, it's just about where your

P and L shifts. From our perspective, obviously this is all the government's money, so whether you take 100 per cent dividend or whether you apply a tax regime, has implications for the P and L, but in the end it is all the government's money. What we're arguing is that our perspective on it is you are no better off in undertaking that regime given the mandate that we have and that there are costs associated with that regime.

DR MUNDY: And the same could be made for a number of other government enterprises.

MS SCOTT: Has EFIC's board sought external assurances that EFIC complies with the relevant Australian Government and international guidelines on bribery of public officials.

MR ARMOUR (EFIC): We can give a very detailed answer on that in terms of the legislation, if you wish, for the record now or we can provide it in writing. It's up to you.

DR MUNDY: We'll take it in writing.

MS SCOTT: We'll take it in writing. Do you require firms to provide EFIC with a copy of their company policy on bribery?

MR ARMOUR (EFIC): For small firms they won't necessarily have an articulated policy. I think that's probably an unreasonable expectation.

MS SCOTT: For large firms?

MR ARMOUR (EFIC): Larger firms normally publish - or large, listed companies will publish their code of conduct or a code of ethics.

DR MUNDY: But if it wasn't published, would you require it?

MR ARMOUR (EFIC): Depending on the jurisdiction, we might very well, yes.

DR MUNDY: Okay.

MR ARMOUR (EFIC): This is a point that has been raised in Senate estimates as well. I think it is important to distinguish our role as a financier versus regulators, and that was the word that was used in the Senate estimates; we are not, in the end, regulators, we are not law enforcement.

DR MUNDY: You will be aware of recent media speculation or media commentary with respect to Leighton. Have you sought and seen Leighton's policy with respect to bribery?

MR ARMOUR (EFIC): You understand the framework I'm working in, in terms of the AFP investigations so I will - - -

DR MUNDY: I'm asking a simple question of fact.

MR ARMOUR (EFIC): Yes, and I will answer this question directly, it's just that I'm foreshadowing there might be limits to what I can say if the questions continue. Yes, we undertake, in fact, an annual review of Leighton. We look at their performance over the past year, which includes a very extensive database search of their activities and whether they might be identified as having done the wrong thing. I have not personally sighted this for a very long period, if at all, but we have referred to it in the past.

DR MUNDY: Are you aware of the media commentary in the Australian of 27 March that no such policy exists with respect to Leighton?

MR ARMOUR (EFIC): It was a Leighton subsidiary, I believe, that the comment related to, rather than Leighton Holdings. Is that right?

DR MUNDY: Okay. Well, the subsidiary.

MR ARMOUR (EFIC): I was aware of the media report. I have to say it didn't strike me as true, but I didn't interrogate it any further.

DR MUNDY: So you have made no efforts to ascertain the truth or otherwise of that media statement, which may reflect upon your dealings with Leighton?

MR ARMOUR (EFIC): I think the whole context of our dealings with Leighton now is - - -

DR MUNDY: Okay, we'll leave it at that. This is question for you, Mr Field. When you gave evidence to us last time, you indicated, with respect to the Ichthys project, which is the LNG development in Darwin, that the form of support that EFIC might give - or form of debt, I think was the word you used, but obviously a loan or a guarantee - was yet to be decided or approved of by the board. I am just curious, given this is a facility onshore and there are clearly no capital goods involved for export, what would be the legal basis for the provision of a loan in that circumstance.

MR FIELD (EFIC): Well, you would have to go to look at the EFIC Act to look at in what circumstances Section 23 operates and you would have to look at the facts surrounding the transaction itself and the transactions within the broader project as well. We have had a look at that and we have considered whether there may be an argument that the facts would support the application of Section 23 in the use of a loan.

DR MUNDY: Okay, what are those facts?

MR FIELD (EFIC): The contractual relationships between the subcontractors and the head contractors or the ultimate end user, being a company which conducts business overseas. In this case, it could be Total, it could be any one of the major head contractors.

DR MUNDY: Forgive me if I'm wrong, but I thought your ability to grant loans was only related to the export of capital goods?

MR FIELD (EFIC): Or services.

DR MUNDY: Or services related to the export of capital goods. Or is related to any export?

MR FIELD (EFIC): I think you have to look at the broader definition of - - -

DR MUNDY: I think this is an important issue and - - -

MR FIELD (EFIC): We haven't got to the conclusion.

DR MUNDY: Okay, well, perhaps you can outline the facts to us.

MR FIELD (EFIC): I don't have the facts with me today. I don't have all the contractual details in my head.

DR MUNDY: I accept that, Mr Field, but perhaps it will be possible for you to give us that information in writing by the close of business tomorrow.

MR FIELD (EFIC): We'll attempt to do that.

MR ARMOUR (EFIC): That would be unreasonable. I think we have got quite a few information requests right now - - -

DR MUNDY: Fair enough, Mr Armour, fair enough. By close of business next Friday would be adequate.

MR ARMOUR (EFIC): The point I'm making, maybe, commissioner, is the board hasn't considered this either, so we're well and truly ahead of management even reaching a conclusion. This is more about deliberation than analysis.

DR MUNDY: I understand that, Mr Armour, but I'm sure you'll be able put to put germane facts to us without subverting your governance processes.

MS SCOTT: Has EFIC engaged a PR consultant or an external adviser to assist in your public relations response to this inquiry?

MR ARMOUR (EFIC): No.

MS SCOTT: Have you asked your clients to make favourable submissions on your behalf to our inquiry?

MR ARMOUR (EFIC): No. We have asked them to participate in the review. We have not asked them to make favourable submissions.

MS SCOTT: Have you provided information to your clients to help them make a submission?

MR ARMOUR (EFIC): Only the copy of your report and our response.

DR MUNDY: Have you had any discussions with those of your clients which have given evidence to this inquiry prior to them giving that evidence?

MR ARMOUR (EFIC): You mean the people who have come to the hearings?

DR MUNDY: Yes.

MR ARMOUR (EFIC): Yes.

DR MUNDY: So you have provided them with advice prior to their giving evidence to us?

MR ARMOUR (EFIC): We haven't given them advice. We've told them about the form of the hearings, particularly for small firms this is a completely new forum for them. We have not counselled them on what to say. We have been absolutely clear that this is their show and they should say what they're going to say, but going to the process remark earlier I think quite a few small firms find this very intimidating.

MS SCOTT: Have you advised your board or participants in this process that the commission's thesis is that financial markets are perfectly efficient and rational?

MR ARMOUR (EFIC): Yes. That is our reading of your report.

MS SCOTT: Could you cite the page number on which you think we state that?

MR ARMOUR (EFIC): Not stated that explicitly.

MR DONNELLY (EFIC): I think it's an inference, commissioner. Basically your observation that market failures are absent except insofar as they apply to newly-exporting SMEs, that amounts to an argument that markets are perfectly efficient and rational.

MS SCOTT: Have you made it clear to people that you're advising that that's an inference that you draw from our report rather than a statement of our position?

MR ARMOUR (EFIC): Again, commissioner, we've just replied - we've given them your report and our response. We have not given them any advice.

MS SCOTT: That's fine. I just want to make it clear - - -

MR DONNELLY (EFIC): I don't give advice to any clients, I'm sorry, commissioner - - -

MS SCOTT: Well, now, have you advised the board that that's the inference that you take from our report?

MR ARMOUR (EFIC): Yes.

MS SCOTT: As an inference?

MR DONNELLY (EFIC): Yes.

MR ARMOUR (EFIC): Yes, correct.

MS SCOTT: So you've made it clear that the inference you take from our report is that?

MR ARMOUR (EFIC): Commissioner, the board also has a full copy of your report, and that was very much their interpretation of what you've written too.

MS SCOTT: Did you contact firms that were unsuccessful in securing EFIC support to give their views on EFIC's products and services?

MR ARMOUR (EFIC): No, commissioner. No, we haven't.

MS SCOTT: Did you contact firms that might be competitors to your clients to encourage their participation in the inquiry process?

MR ARMOUR (EFIC): Commissioner, we don't necessarily have a relationship with either of the two categories of firms that you identified. I mean if that does concern you then that's your process to run.

DR MUNDY: Can I just ask, the submission that was given to us at the close of business of the day prior to the last hearing, was that approved by your board?

MR ARMOUR (EFIC): The board reviewed it, yes, definitely.

DR MUNDY: No, I asked was it approved?

MR ARMOUR (EFIC): The minutes, noted or approved?

DR MUNDY: For the record Mr Armour's staff indicated it was noted. So we can take it therefore that the views expressed in it are collectively the views of the board?

MR ARMOUR (EFIC): Yes.

DR MUNDY: Thank you.

MS SCOTT: In your supplementary submission you have pointed out that you consider you have low cost to income ratio. The Commission considered this in its draft report but it was concerned that this might reflect EFIC's different business model to the banks: sourcing funds from wholesale markets as opposed to depositors through a bank network. Do you have a view on this? Can you go back and justify the idea that you would have a low cost to income ratio? Would that reflect - I'm particularly interested in your origination business rather than your Treasury function now.

MR ARMOUR (EFIC): The benchmarks I would draw from, commissioner, would be both from the insurance and the banking sector. So when the insurance sector - operating costs of somewhere between 85 and 90 per cent of revenue, including claims, which is - you know, that's the cost that we're talking about, are considered a very good result. It is not unusual in the insurance sector to have what's called a combined ratio loss, that is, meaning on an annual basis you lose money. In the banking sector that is probably most relevant to EFIC from the perspective of corporate or institutional, they don't actually - the banks don't actually report on a segment basis on that. If you look at investment banks, well, their bonuses alone are

50 per cent of revenue, we know that, but that's not the segment we're working in. But we feel comfortable, again, given the experience of the people involved, that we are at least comparable with what's happening in both the banking and insurance markets for the sort of business that we're doing.

MS SCOTT: Do you consider that it would normally be the case that there would be enough capital support for all commercially worthwhile projects in Australia or is the current situation, you think, simply a reflection of the hangover of the GFC and the Eurozone crisis?

MR ARMOUR (EFIC): I think those two factors, commissioner, are definitely in play, but I would emphasise too; simply the scale of the projects that are being contemplated right now. I think that is also a challenge. I think we didn't make this point that even in a perfectly normal functioning environment like 2006 these are very large projects. Very large projects; they are technologically, from an engineering perspective, complex. If you talk to the firms involved, they are the largest they've ever seen. They represent, if you like, a new wave of investment that is quite significant. I think that's a challenge for the markets, quite apart from the continued implications of the GFC and the Eurozone crisis.

DR MUNDY: So on that basis, Mr Armour, is it reasonable to conclude that absent the GFC these issues with these large projects would still exist?

MR ARMOUR (EFIC): I would concede it's a possibility, but I can't construct the alternate argument to say definitively. But I think if you look at the withdrawal, particularly of Europe banking capacity, that's clearly had an impact on the project finance market. You've seen Asian bank capacity come back in - this is all public knowledge, it's reported by the RBA et cetera - but not to the level that the Europeans have left. Obviously we're hopeful, and I said this previously at the hearing, that we're not needed any more in two or three years. But it will be a matter of how much Asian capacity comes in and how much European capacity might resume.

MS SCOTT: In the past when there has been a resource boom in Australia do you think EFIC should have been able to play a large role then or been able to effectively operate in that segment of the market?

MR ARMOUR (EFIC): I'm sorry, commissioner, I simply don't have the history to comment on that. I mean I can offer one insight, which is the first major WA Woodside project was supported by the Japanese government through their export credit agency.

DR MUNDY: It's interesting you raise the Pluto project, which I have some familiarity with.

MR ARMOUR (EFIC): No, not Pluto, sorry.

DR MUNDY: Not Pluto? North West Shelf?

MR ARMOUR (EFIC): Yes, North West Shelf, I think, was the JBIC facility.

DR MUNDY: Yes, JBIC, Shell and a number of other major oil companies.

MR ARMOUR (EFIC): Yes, that's right. I'm not advancing it as an argument.

DR MUNDY: No.

MR ARMOUR (EFIC): I'm just saying that ECAs have been involved.

DR MUNDY: No, I just want to clarify this. Would the Japanese government's involvement with that have been in part motivated by their desire for resource security?

MR ARMOUR (EFIC): Absolutely, that's the point we were discussing earlier. Their rationale for being involved in our market is quite broad, they have their own national interest.

MS SCOTT: Would you view a shortage of debt finance in a very active market, lots of opportunities, as a market failure?

MR ARMOUR (EFIC): Very general question. Could you repeat it again? I need to think it through.

MS SCOTT: Do you equate a shortage of debt finance in an active market where there's lots of opportunities as a market failure?

MR ARMOUR (EFIC): There is demand that exceeds supply of debt.

MS SCOTT: The price will ultimately adjust.

MR ARMOUR (EFIC): Ultimately.

MS SCOTT: Do you think you should be stepping into that breach?

MR ARMOUR (EFIC): No, there may be occasions when the risk is the constraining factor, so we look at it from the perspective that, you know, is this issue relating to the risk that's involved? I would think in a low-risk market - it has different characteristics to a high-risk market. I'm just trying to give you a generalised answer to the question.

MS SCOTT: You have pointed to the fact that there is movement in the market and that Asian institutions are showing increasing interest, yet at other times it might be the case that other participants withdraw. Should the Australian government have EFIC in sort of a holding capacity, to enter into circumstances when you consider that markets are operating totally rationally or where there is a short-term shortage of capital?

MR ARMOUR (EFIC):   I think that is the purpose of the exchange around the corporate plan in the statement of expectations. We notify government if we feel, not just in Australia but in any market that might be a major export destination, that there could be an issue. Through that process of consultation and the development of the corporate plan, we develop our response to it, if it's appropriate. I don't know if we need to be formally on notice, if I'm characterising your direction properly. I don't know if that's something that the government requires. We certainly don't require it; in the sense that we will respond if the government directs us to.

MS SCOTT: Recent APRA data supports the claim that European banks have withdrawn; but, as you note, Australian and Asian banks are now increasingly active in the market. Would you expect that, if this continues, you would put a recommendation to the board that you stop engaging in large projects?

MR ARMOUR (EFIC):   Yes.

MS SCOTT: What sign would you take it that - when would that trigger point - when would you consider that you would be satisfied that the market gap doesn't operate in relation to these large projects any more?

MR ARMOUR (EFIC):   I think we would undertake the same testing that we're doing now in the - - -

MS SCOTT: Sorry. If for example domestic banks and the Asian banks were to take the place in quantum of European banks, would that be sufficient trigger for you to then - - -

MR ARMOUR (EFIC):   And if the export credit agencies who may be involved in a particular project are equally comfortable to go ahead without us, then there is no need for us. It's a good question from the perspective of, you know, how does the board contemplate this. We are not putting forward a dozen or two dozen transactions that we should be supporting, so we don't have that sort of portfolio approach. We've come at this discussion before. The response that you're describing may simply be after a period of time; we say to the board, "Look, people are aware of our capabilities. Export credit agencies are capable of doing what they're doing. Banks are capable of providing the limit that is necessary. You haven't seen anything on this for a long time and we don't expect you will again."

MS SCOTT: Okay. If I get it right, if the Asian and Australian banks were effectively meeting the level of activity previously undertaken by the European banks, you would recommend to your board that EFIC does not proceed with these large projects.

MR ARMOUR (EFIC): No, I wouldn't.

MS SCOTT: The only thing that might influence your advice to the board would be if other ECAs particularly required your involvement?

MR ARMOUR (EFIC): I wouldn't characterise it that simply, commissioner, because the other side is the demand side. So even if the combination of the inflow of capital met the level previously provided by the European banks and the ECAs were prepared to provide the level they previously provided, there still is the demand dimension; what is happening in the economy, what sort of funding is required. I think that is not just an EFIC issue, that is an infrastructure finance issue that is a broader issue for the economy.

MS SCOTT: So it's not so much the GFC or the European banks. As long as there is always a case that demand exceeds supply in large projects, you would see a role for EFIC. Is that what you're saying?

MR ARMOUR (EFIC): Again, commissioner, I may not be articulating this very clearly, but I don't - I'm not laying down markers in the way that you're characterising.

MS SCOTT: I'm trying to establish what - - -

MR ARMOUR (EFIC): No, I understand. What I'm saying, very simply, is if there is a demand and supply imbalance that is driven by a lack of supply from bank capacity or an aggregate level of demand, given the size of the projects, it may be appropriate for EFIC to participate. It won't be a hard and fast rule that we should. There has to be careful deliberation around the circumstances under which we provide that funding or that support.

MS SCOTT: Thank you, Mr Armour. I think I might draw my questions now to a close. I think we have indicated that we would very much appreciate receiving some of your answers by COB tomorrow and, I think, in the case of a written question, we would be keen to get your advice on that also by tomorrow. But there was one question that Dr Mundy indicated that we could get your answer within a working week. Thank you for your participation today and for your offices of EFIC. I thank the team and our transcription service and I now draw this hearing to a close. I thank everyone for attending.

MR ARMOUR (EFIC): Commissioner, if we could possibly compare notes on what exactly is required.

MS SCOTT: Sure.

AT 12.46 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY