

# **EXPLANATORY STATEMENT**

**Issued by authority of the Minister for Industry and Science, and  
the Minister for Finance**

*National Reconstruction Fund Corporation Act 2023*

*National Reconstruction Fund Corporation (Investment Mandate) Direction 2023*

## **Purpose and Operation**

Under the *National Reconstruction Fund Corporation Act 2023* (the NRFC Act), the purpose of the National Reconstruction Fund Corporation (the Corporation) is to facilitate increased flows of finance into priority areas of the Australian economy.<sup>1</sup> It is the Government's intention that the Corporation will perform this role in order to transform and diversify Australian industry, create secure, well-paying jobs, and boost sovereign capability. In performing this role, the types of investment the Corporation may make includes loans, guarantees and equity.

Under the NRFC Act, the Board of the Corporation (the Board) is responsible for deciding the strategies and policies to be followed by the Corporation and ensuring the proper, efficient and effective performance of the Corporation's functions.

The Corporation and its subsidiaries (Corporation bodies), will make individual investment decisions independently of Government. The Minister for Industry and Science and the Minister for Finance may issue one or more directions to the Board, under subsection 71(1) of the NRFC Act, in relation to the exercise of the Corporation's investment powers or the performance of the Corporation's investment functions, or both, and must issue at least one direction. Directions issued in this manner are known collectively as the Corporation's Investment Mandate (Investment Mandate). The purpose of the Investment Mandate is to provide a mechanism for the Commonwealth Government to articulate its broad expectations on the functions of the Corporation and how it invests and engages with risk.

The following statutory pre-conditions have been met in relation to the Investment Mandate:

- The responsible Ministers have had regard to the object of the NRFC Act, and any other matters they considered relevant, in preparing the Investment Mandate.<sup>2</sup>
- The Investment Mandate is consistent with the NRFC Act and does not directly or indirectly require Corporation bodies to make (or not to make) any particular investment.<sup>3</sup>

Further details about the *National Reconstruction Fund Corporation (Investment Mandate) Direction 2023* (the Mandate) are outlined in Attachment A.

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<sup>1</sup> As prescribed by the National Reconstruction Fund Corporation (Priority Areas) Declaration 2023 (the Declaration).

<sup>2</sup> See subsection 71(2) of the NRFC Act.

<sup>3</sup> See section 72 of the NRFC Act.

## **Authority**

Section 71 of the NRFC Act provides authority for the legislative instrument. Section 74 provides that the Board must take all reasonable steps to ensure that the Corporation bodies comply with the Mandate, including the process in the event the Board becomes aware that the Corporation or a subsidiary has failed to comply.

## **Consultation**

[Pursuant to section 73 of the NRFC Act, the responsible Ministers have consulted the Board during the preparation of the Mandate. The Board's response, which the Ministers subsequently considered, is tabled and publicly available.]

A consultation paper on the design of the Corporation (including the Mandate) was released on 30 November 2022. Submissions were open to 3 February 2023. More than 250 submissions were received from businesses, peak bodies, financiers, unions, specialist investment vehicles (SIVs), all levels of government, and the community.

Virtual consultations were held throughout December 2022 and January 2023. More than 48 virtual consultations were conducted, and the departments engaged with more than 430 organisations and individuals through roundtables and one-on-one meetings. Consultations included engagement with business and peak industry organisations, unions, financiers, other SIVs, indigenous stakeholders, Regional Development Associations and members of the public.

A Reference Group consisting of industry experts was also consulted on the key parameters in the Mandate.

## **Regulation Impact Statement**

It is estimated that the regulatory burden is likely to be minor (OIA 23-04299).

**Details of the *National Reconstruction Corporation (Investment Mandate) Direction 2023***

**PART 1 – PRELIMINARY**

**Section 1 – Name**

This section specifies the name of the instrument as the *National Reconstruction Fund Corporation (Investment Mandate) Direction 2023*.

Section 42 of the *Legislation Act 2003* (the Legislation Act) (which deals with the disallowance of legislative instruments) does not apply to this instrument: refer to section 44 of the Legislation Act and section 9 of the *Legislation (Exemptions and Other Matters) Regulation 2015*. Part 6 of the Legislation Act (which deals with the sunseting of legislative instruments) does not apply to this instrument: refer to section 54 of the Legislation Act and section 11 of the *Legislation (Exemptions and Other Matters) Regulation 2015*.

It is appropriate for the Mandate to not be subject to disallowance. Making the instrument subject to disallowance would introduce significant operational uncertainty for the Corporation and would be inconsistent with like instruments for other entities, including the Clean Energy Finance Corporation (CEFC) and the Northern Australia Infrastructure Facility (NAIF).

**Section 2 – Commencement**

Section 2 provides that the provisions set out in the Mandate commence on the day after it is registered on the Federal Register of Legislation.

**Section 3 – Authority**

Section 3 provides that the Mandate is made under subsection 71(1) of the NRFC Act.

**Section 4 – Object**

Section 4 sets out that the object of the instrument is to ensure that the Board performs the Corporation's investment functions and exercises the Corporation's investment powers in a commercial manner to deliver a positive return to the Australian Government over time and so as to invest to support, diversify and transform Australia's industry and economy.

By requiring it to operate in a commercial manner, the Corporation will need to invest responsibly and manage risk such that it is financially self-sufficient and achieves the portfolio benchmark return (see section 8 of the Mandate). As the Corporation will not award grants, the Corporation's investments must be made with an expectation of financial return.

## Section 5 – Simplified outline of this instrument

The simplified outline of the Mandate is included to assist readers in understanding the substantive provisions. It is not intended to be comprehensive and readers should rely on the substantive provisions.

## Section 6 – Definitions

This section provides definitions of terms used in the instrument. Although these definitions are largely self-explanatory, the following points should be noted in particular:

- “Investment practices” is defined in the Mandate, and used in this Explanatory Statement, to mean the exercise of the Corporation’s investment powers and performance of the Corporation’s investment functions.
- The calculation of the Corporation’s “portfolio benchmark return” is described in section 8 of this Explanatory Statement.
- Further terms used in this Explanatory Statement are explained in footnotes where appropriate.

## **PART 2 – DIRECTIONS**

### Section 7 – Introduction

Section 7 provides an introduction to Part 2, setting out the Government’s broad expectations regarding how the Corporation should interpret the directions that follow in this part of the Mandate. Section 7 is not a direction. It sets out that the Corporation is expected to help attract additional private finance and investment in the priority areas<sup>4</sup> in order to transform and diversify Australian industry, and to improve the competitiveness of Australian businesses across the domestic industry value chain.<sup>5</sup>

In line with its policy intent, the Corporation is expected to have regard to public policy outcomes when considering investments, which means taking into account the Investment Considerations listed in section 10 of the Mandate, subsections 17 (3A) and (4) of the NRFC Act.

### Section 8 – Portfolio benchmark return

Section 8 sets out the Corporation’s portfolio benchmark rate of return.

The Corporation must target a cumulative average return of 2-3 per cent above a five-year Australian Government bond rate as the benchmark return of the Corporation’s portfolio over the medium to long term.

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<sup>4</sup> As declared in the Declaration.

<sup>5</sup> The “industry value chain” takes into account all steps from pre- through to post-production at which value can be added, including research and development (R&D), design, logistics, production, distribution, sales and services.

The Australian Government bond rate is to be calculated from individual reference rates using the five-year Australian Government bond rate<sup>6</sup> applicable at the time of each investment, and weighting the portfolio for the timing and relative to the quantum of each individual investment.

Performance against the portfolio benchmark return will be measured after deducting credit losses but before deducting the Corporation's operating expenses (those not directly related to making investments) and will be published in the Corporation's annual report. The Corporation will follow the Australian Accounting Standards where applicable in calculating and measuring its return (for example, in particular, AASB 9 *Financial Instruments*).

The portfolio benchmark return target is expected to be earned across the portfolio of investments over the medium- to long-term. Individual investments could be made with expected individual returns above or below (using the concessionality principles set out in Section 16 of the Mandate) the portfolio benchmark return.

Proponents should not expect to be able to access financing from the Corporation at the portfolio benchmark return. The Corporation is required to apply commercial rigour in assessing all investments. The actual return the Corporation seeks for any given investment will be a risk-adjusted return reflecting the individual characteristics of specific projects, the need to cover the operating expenses of the Corporation, and the requirement to target the portfolio benchmark return on a portfolio basis, in addition to the desired public policy outcomes<sup>7</sup>.

The Government is committed to driving the transformation and diversification of Australia's industry and economy over the long term. The Mandate therefore establishes medium- to long-term portfolio performance measures with the intention to conduct a review of the portfolio benchmark return three years after commencement of the Mandate to ensure it is appropriate.

### Section 9 – Portfolio risk

Section 9 sets out the Corporation's portfolio risk.

Paragraph 9(1)(a) provides that in targeting the portfolio benchmark return, the Corporation must operate with a commercial approach, this includes but is not limited to undertaking appropriate due diligence and credit and investment risk assessment processes.

Paragraph 9(1)(b) further provides that the Corporation must also seek to develop an overall portfolio that is sufficiently diversified and has an acceptable but not excessive level of risk.

Further to paragraph 9(1)(b), subsection 9(2) provides that the level of risk deemed acceptable by the Corporation may be higher than the risk tolerance of commercial

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<sup>6</sup> The five-year Australian Government bond rate is the bond rate as published by the Reserve Bank of Australia immediately preceding the date a binding investment agreement is executed. The bond market yield is to be used.

<sup>7</sup> Refer to section 7 of this Explanatory Statement for an explanation of "public policy outcomes".

banks and private sector investors, if this higher risk tolerance supports the objects of the NRFC Act and this instrument. In particular, the Government has directed the Corporation to diversify and transform Australia’s industry and economy. This focus may increase the Corporation’s exposure to credit risk as transformative activities may have a higher risk profile than established, business-as-usual activities and therefore the overall level of risk in the Corporation’s portfolio may increase.

Subsection 9(3) provides the Corporation may take on higher risk (when compared to the risk that it would normally consider acceptable for other investments) for investments in emerging technologies and industries, investments that support Australia’s strategic interests (e.g. investments in support of Australia’s national security, sovereign capability or supply chain resilience), or projects with longer term payback periods.

When considering the Portfolio risk outline in the Mandate, the Corporation will make a range of investments, including those aimed at transforming Australia’s industry and economy. Some of these investments will be in emerging technologies and technically complex projects that carry higher risk than what the market might typically accept. Consequently, in practice this will involve some short-term volatility in the Corporation’s returns, including losses or provisions in some projects and the possibility of losses in some years where there is significantly worse asset performance than expected. This includes potential losses in the early years, which in part reflects why the Corporation’s portfolio benchmark return is measured over the medium to long term.

In recognition of any volatility in the Corporation’s returns, subsection 9(4) sets out the Government’s direction that the Corporation will periodically review its investment and operational practices for the purposes of managing the risk of its portfolio over time.

## Section 10 – Investment considerations

Section 10 sets out the considerations the Corporation must take into account when carrying out its investment practices.

Subsection 10(1) provides that the Corporation must have regard to the matters set out in subsection 17(3A) of the NRFC Act, namely:

- (a) the desirability of transforming Australia’s industry and economy by:
  - (i) growing or improving Australia’s industrial capability<sup>8</sup>; or
  - (ii) improving Australian industry’s ability to pursue value-adding opportunities<sup>9</sup>; or
  - (iii) supporting a long-term improvement in Australia’s economic diversity;and
- (b) the desirability of attracting private sector finance or investments into the priority areas of the Australian economy; and

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<sup>8</sup> “Grow” in this context is taken to mean growing both new and existing industrial capabilities.

<sup>9</sup> “Value-adding opportunities” are taken to mean opportunities to improve competitiveness based on additional value offered to the consumer, rather than low cost alone, across the entire industry value chain from pre- through to post-production (see also footnote 7 in reference to “industry value chain”).

- (c) Australia's greenhouse gas emissions reduction targets and the desirability of supporting decarbonisation; and
- (d) the desirability of creating secure jobs and a skilled and adaptable workforce; and
- (e) the desirability of enhancing Australia's resilience against supply chain vulnerabilities; and
- (f) the desirability of encouraging the commercialisation of Australian innovation and technology.

Subsection 10(1) also refers to subsection 17(4) of the NRFC Act, providing that the Corporation must have regard to the desirability of encouraging and improving economic participation by historically underrepresented groups, including:

- (a) women; and
- (b) First Nations Australians; and
- (c) people with a disability; and
- (d) people of culturally and linguistically diverse backgrounds

Subsection 10(2) further provides that the Corporation must also have regard to the desirability of investments to help support sustainability and circular economy principles and solutions, and regional development. The Corporation must also have regard to national security. These terms are understood as follows:

#### *Circular economy*

The intention underlying subparagraph 10(2)(a)(i) is to ensure that, in considering its investment activities, the Corporation seek to strengthen Australia's circular manufacturing capabilities, focusing on:

- Resource efficiency, for example, by supporting projects that design and manufacture products that can be reused, recycled or reprocessed at their end of use and/or those that avoid the creation of waste and pollution.
- Resource circularity, for example, by supporting projects that use recycled content in manufacturing (including from advanced and organic recycling processes).
- Resource productivity, for example, by supporting projects that do more with less virgin materials and energy inputs.
- Resource regeneration, for example, by supporting projects that substitute materials and processes that harm the environment, with regenerative resources.

#### *Regional development*

Regional development, as used in subparagraph 10(2)(a)(ii), is intended to refer to activities that have the potential to support the long-term economic development of Australia's regions and reduce economic disparities between regions and cities.

The intention underlying subparagraph 10(2)(a)(ii) is to ensure that, in considering its investment activities, the Corporation has regard to the Government's broader approach to regional investment, which places regions and their people at the centre

of decision-making, ensuring investments are locally informed, supported, and draw on a region's unique strengths.

The intention additionally is that Corporation consider the broader social and economic context of a region and the potential impacts of its investments (to inform this, the Corporation should where possible, consider measuring their impacts). This includes considering interactions with other public or private investments or activities in the region when evaluating investment proposals. Where appropriate, the Corporation should seek to consult with relevant State, Territory or Commonwealth government agencies, to ensure its investments complement existing public or private investment activities in the region (see also sections 11 and 13 of the Mandate).

### *National security*

The Corporation's investment activity could provide financing to an entity which produces technologies, products or services that could be used for purposes that are contrary to Australia's national security. For this reason, in considering its investment activities, the Corporation must also have regard to national security, for example by conducting national security assessments as part of its risk management processes. The Corporation may also have regard to positive outcomes on national security from a particular investment.

### Section 11 – Corporation must take medium- to long-term outlook

Subsection 11(1) directs the Corporation to take a medium- to long-term outlook in relation to its investment practices. This ensures the Corporation has the flexibility to offer patient capital to meet its policy objectives. This provision should not be interpreted as preventing the Corporation from providing short-term investments, or a series of several short-term investments to deliver long-term outcomes.

Further, to ensure that the Corporation does not unduly displace alternative private sector support where such support is present or emerges, subsection 11(2) preserves the Corporation's ability to take short-term actions to make or realise investments, for example, where the private market is able to take over the financing and where this is consistent with the NRFC Act and the Mandate. For example, in the case of equity investments, the Corporation may seek to realise investments if it is appropriate to do so and where the private sector can take over in a manner that aligns with the Corporation's objectives.

### Section 12 – Corporation must consider impacts of Corporation's investment practices

Section 12 provides that investments of the Corporation should not disrupt areas where the market is functioning well. The Corporation nevertheless has the potential to impact on other market participants and the operation of Australian financial markets. The Corporation should always consider this potential impact when making investment decisions.

The Corporation should, as far as is reasonably practicable, avoid competing with private sector investment where such investment is present, or competing with other Commonwealth, State or Territory entities that are also able to, or already do, support



investments in the priority areas of the Australian economy as specified in the Declaration. Instead, it is intended that the Corporation complement and attract additional private investment and complement (not duplicate) public sector investment, including investment through existing Australian Government SIVs such as the CEFC, NAIF, Regional Investment Corporation and Export Finance Australia (EFA). For example, the Corporation should not seek to refinance existing debt held by other SIVs at a lower rate where it is not required.

### Section 13 – Corporation not to damage Commonwealth’s reputation

Section 13 provides that the Corporation has a responsibility not to act in a way that is likely to cause damage to the Commonwealth’s reputation.

### Section 14 – Corporation must collaborate and cooperate

Section 14 directs the Corporation to cooperate and collaborate with the private sector and other Commonwealth, State or Territory entities that are also able to support investments in the priority areas (for example, but not limited to, the CEFC, NAIF and EFA) to minimise potential overlap or duplication and coordinate co-investment where appropriate, and to consider opportunities (including under subsection 14(4) in relation to the transition to net zero emissions).

The Corporation may invest alongside other SIVs where appropriate, and subsection 14(2) provides a non-exhaustive list of relevant agencies.

Subsection 14(3) defines a State and Territory entity to mean a State or Territory, or a body corporate established for a public purpose by or under a law of a State or Territory.

### Section 15 – Targeted financing levels

Section 15 outlines six areas in which the Corporation is required to target certain financing levels over the medium to long term:

- Renewables and low emission technologies: up to \$3 billion
- Medical manufacturing: \$1.5 billion
- Value adding in resources: \$1 billion
- Critical technologies in the national interest: \$1 billion
- Advanced manufacturing: \$1 billion
- Agriculture, forestry, fisheries, food and fibre: \$500 million

This section does not require the Corporation to manage separate sub-funds for each of the identified areas. It is, however, the Government’s expectation that the Corporation report its progress against these target financing levels as part of its regular reporting.

If, over the medium to long term, the Corporation becomes aware that it is falling short of any one of these target financing levels, it should seek to prioritise its investments going forward such that these levels are met within a reasonable and practicable period of time.

The six identified areas in which the Corporation is to target these financing levels do not correspond exactly with the priority areas of the Australian economy specified in the Declaration. As such, this section notes that investments in a single priority area may be counted towards any other appropriate target or targets set out in this section.

To determine which types of technology qualify as ‘critical’, the Corporation may refer to the Government’s most recent List of Critical Technologies in the National Interest as relevant at the time of investment. Further details are available at: <https://www.industry.gov.au/publications/action-plan-critical-technologies/list-critical-technologies-national-interest>

This section is not intended to override other provisions of the Investment Mandate: in targeting these funding levels, the Corporation still must perform its investment functions and exercise its investment powers in accordance with the NRFC Act.

### Section 16 – Limits on concessional financial accommodation

Section 16 sets out directions in relation to the Corporation providing concessional finance.

The Corporation is able to use a wide range of investment tools to facilitate flows of finance into the priority areas of the Australian economy.<sup>10</sup> This includes providing commercial and concessional finance where necessary to deliver on the Corporation’s policy intent. Concessional finance is provided on more favourable terms than the borrower could obtain in the private market. For debt investments, concessions may be provided in many forms, for example, but not limited to, lower than market interest rates, longer loan tenors, subordinated positions, income contingent repayment terms, or additional/longer or more flexible grace periods before the payment of the principal and/or interest is due. For equity investments, concessions may include, but not be limited to, different classes of shares and lower equity internal rate of return.

Section 16 provides that the Corporation must not provide financial accommodation on concessional terms unless it is satisfied that (a) this is the most appropriate way of achieving particular policy outcomes<sup>11</sup>, (b) based on a reasonable qualitative assessment, the level of concessionality is commensurate with the anticipated economic benefits and public policy outcomes, and (c) the concessionality provided is the minimum that would both achieve those benefits and outcomes and allow the investment proposal to proceed.

### Section 17 – Limits on equity investments

Section 17 provides that the Corporation must not, whether individually or alongside other Commonwealth entities, take a controlling equity stake in any entity.

Subsection 17(1) sets out that Corporation bodies must not acquire an equity interest in an entity if it would result in Corporation bodies and any other Commonwealth entities together holding a majority of equity interests in the entity or being in the position to control the entity.

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<sup>10</sup> As specified in the Declaration.

<sup>11</sup> Refer to section 7 of this Explanatory Statement for an explanation of “public policy outcomes”.

Under subsections 17(2) and (3), where a Corporation body holds an equity interest in an entity and becomes aware that this interest would breach subsection 17(1), it must take steps to realise sufficient equity interests to rectify the situation as soon as is reasonably practicable after becoming aware of the fact.

Subsection 17(4) provides that “control” in this section has the same meaning as in the definition of “subsidiary” in the *Public Governance, Performance and Accountability Act 2013*, which defines it as having the same meaning “as in the accounting standard that applies for the purpose of deciding whether a company has to prepare consolidated financial statements under the *Corporations Act 2001*”.

### Section 18 – Limits on guarantees

Section 18 sets out limits on guarantees provided by the Corporation.

Guarantees include any form of monetary commitment supporting the performance of an obligation. Under the Australian Government reporting framework, guarantees are to be accounted for in accordance with the Australian Accounting Standards.

Guarantees pose a particular risk to the Corporation’s balance sheet and can have unexpected consequences when called. As such, section 18 provides that the Corporation should not give guarantees unless this is the most appropriate way of achieving particular public policy outcomes.<sup>12</sup>

Section 18 further requires the Corporation to ensure that any guarantee that it does give is appropriately limited and quantifiable, and that where guarantees are used the total value of these guarantees does not exceed 5 per cent of the total amount that has been credited to the Corporation’s Special Account<sup>13</sup>.

### Section 19 – Australian industry participation

Subsection 19(1) outlines the application of Australian Industry Participation (AIP) Plans to the Corporation’s investment activities. The application of AIP Plans to investments made by the Corporation is aimed at increasing opportunities for capable and competitive Australian and New Zealand small and medium sized enterprises to participate in major projects where government investment is equal to or exceeds \$20 million (GST inclusive).

An AIP Plan details how a project proponent will provide full, fair and reasonable opportunity to Australian industry to participate in a project. This applies to any subcontracting or purchasing opportunities that may be available. AIP Plans do not mandate the use of Australian industry, but rather aim to provide Australian industry with the opportunity to demonstrate their capabilities and capacity<sup>14</sup>.

It is anticipated that prior to contract execution with a loan recipient, the Corporation should engage with the Commonwealth AIP team. The Commonwealth AIP team will

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<sup>12</sup> Refer to section 7 of this Explanatory Statement for an explanation of “public policy outcomes”.

<sup>13</sup> As defined by section 5 of the NRFC Act.

<sup>14</sup> Further information on the application of AIP Plans can be found (as at 1 July 2023) at: <https://www.industry.gov.au/major-projects-and-procurement/australian-industry-participation>

contact the Corporation if it determines that a full AIP plan would likely increase opportunities for Australian Businesses.

If required, the Corporation may engage with the Commonwealth AIP team to assist in drafting contract terms to include in funding agreements that assist recipients in their AIP obligations.

Subsection 19(2) directs the Corporation to consult with the Department of Finance regarding the application of the Australian Government's Buy Australian Plan. The Buy Australian Plan is intended to improve the way government contracts work and builds domestic industry capability through the Australian Government's purchasing power.

In respect of the Buy Australian Plan, the Corporation will consult with the Department of Finance on relevant investment policies or strategies, rather than specific decisions or issues in relation to particular investments or non-investment matters.