PARLIAMENT OF TASMANIA

PARLIAMENTARY STANDING COMMITTEE OF PUBLIC ACCOUNTS

INQUIRY INTO CERTAIN MATTERS RELATED TO THE SALE OF THE TRUST BANK

Laid upon the Tables of both Houses of Parliament

The Committee was appointed under the provisions of section 2 of the Public Accounts Committee Act 1979 (No. 54)

MEMBERS OF THE COMMITTEE

LEGISLATIVE COUNCIL
Hon. A. W. Fletcher (Chair)
Hon. C. L. Ratney
Hon. J. S. Wilkinson

HOUSE OF ASSEMBLY
Mr K. J. Bacon
Ms R. R. Cheek
Hon. G. H. James

By Authority: Government Printer, Tasmania
TRUST BANK INQUIRY 2000

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TRUST BANK INQUIRY 2000

ANALYSIS

The Public Accounts Committee (PAC) has found this inquiry very challenging. It has sought to balance the rights of the public to know about issues related to the management of public sector finances against the competing rights of Trust Bank, a private sector organisation to conduct its business distanced from parliamentary intrusion.

The decision to examine the issue was based on the fact that there were public funds invested in or lodged with the institution.

The PAC is aware of the enormous pressure facing the management of the Trust Bank during late 1998 and most of 1999. We have documented in this report reasons for that pressure.

The sale of Trust Bank to Colonial was considered by many to be a very negative outcome for Tasmania and Tasmanians. The major concerns revolved around the loss of ownership and control of another of the few remaining State icons to the mainland.

The PAC finds that the Trust Bank Board had no option but to seek a 100% sale of the asset and that the action was in the best interests of the bank, the staff, the customers and the people of Tasmania generally.

The PAC itemises for the record the benefits flowing to the State of the sale.

- An ailing financial institution has been resurrected.
- State Debt has already been reduced by $98.24 million. If no further claims are made on the Trust Account it is estimated that $134.1 million will ultimately be used to retire State debt.
- Stamp duty revenue of $5 million from the sale of the Bank has been paid into the Consolidated Fund and Treasury has paid $200 000 to the Crown to meet the costs associated with the sale the bank.
- A community fund has been established that will each year consider applications from community groups for funds to serve the community. The community fund will have half the interest saved by the reduction in State Debt available each year for such purposes. It is estimated that the State community fund under the auspices of the State Government will distribute in the vicinity of $3 million each year.
FINDINGS: MR. P KEMP

- The payment to Mr. P. Kemp representing salary and Director’s fees, superannuation and unused leave was according to established arrangements.
- The Board had the authority to approve an ex gratia payment of $105,299 to Mr. Kemp.
- The ex gratia payment to Mr. Kemp was provided on the basis that the Board believed that Mr. Kemp’s 14 years of service at senior executive manager level equated to 30 years of service given to the Bank by any other employee.
- Rule 23 of the Employees Gratuity Fund was the basis for determining the quantum of the payment to Mr. Kemp. Advice was taken from the Actuary, the Bank’s HR and Remuneration staff and the Board Secretary prior to the decision being made.
- While the evidence was not conclusive the PAC accepts that the Trust Bank employed Mr. P. Kemp as an individual employee in the general understanding of the term.

FINDINGS: MR. AIREY

- The situation outlined in Mr. Loughran’s letter of 5 June 2000 to the extent that the Bank needed to arrange succession and secure strong leadership for it to move forward’ to a strategic partnership and/or a public float, was the reality.
- As a result of the circumstances Mr. Airey was in a position of strength when negotiating his conditions with the Trust Bank Board and seized every opportunity to further his own benefit.
- There was nothing irregular in the appointment of Mr. Airey and any businessman of experience exercising similar bargaining power would have used this strength to deliver a favourable outcome.
- There was no evidence to suggest there was a legal obligation to pay compensation for ‘loss of opportunity’ to Mr. Airey.
- The Trust Bank’s legal obligation was to meet the terms and conditions of the service agreement as amended.
- Given the limited time available to Mr Airey to improve the performance of the Trust Bank the maximum value of those ‘at risk’ and ‘synthetic stock options’ elements of the Total Remuneration package obligations at the time of sale was likely to be a relatively insignificant amount.
- The valuation documented in the Service Agreement Second Addendum was attributed to the synthetic stock option when in fact the valuation should be for the ‘loss of opportunity’ to earn those options over time.
The payment of $1.2 million was over and above that which could be attributed to the Trust Bank’s obligations under the Service Agreement dated 31 March 1999 as amended.

The commercial reality of the time gave the Trust Bank Board little option but to negotiate a compensation package for Mr. Airey.

The outcomes of the negotiations which paved the way to a successful sale of the asset was in the best interests of all the stakeholders.

**FINDINGS: NON-EXECUTIVE DIRECTORS**

- The 1999 payment was inflated by the inclusion of termination payments to Mr. Paul Kemp and Mr. David Airey.
- Non-Executive Directors were paid according to their entitlements.
- Mr. Don Challen’s fees and retirement allowances were paid directly to the Consolidated Fund to compensate for his absence from Crown work.
- Payments made on the retirement of Non Executive Board members were according to longstanding Board Rules.

**FINDINGS: TECHNOLOGY PLATFORM**

- For a period prior to 1994 the Trust Bank’s commitment to IT was under funded.
- The need for IT upgrade was known to management and the Board of Trust Bank in early 1994 and action was initiated with a view to meeting the need.
- The process leading to the commissioning of Price Waterhouse as the preferred consultant was valid and involved the consideration of at least three alternate consultants.
- Price Waterhouse thoroughly considered the range of options and recommended accordingly.
- Price Waterhouse advised the Board of Trust Bank that the recommended software was 77% compatible with the Trust Bank need.
- Price Waterhouse estimated that 500 additional man-hours were required to customise the software to the Trust Bank need.
- In fact the need was much greater and as a result of the customisation program the actual cost escalated by $7 million.
- During the commissioning process the ‘old’ and the ‘new’ systems were run in parallel for a period to confirm the accuracy of reporting.
- The supply and installation of the hardware component of the IT platform was delivered on time and within estimates.
FINDINGS: FINANCIAL INFORMATION AVAILABLE TO DIRECTORS

- Appropriate data and reports were available to the Board during the critical period from December 1998 to April 1999.
- The combination of a new technology platform and a significant change in bottom line trends caused uncertainty and alarm in the minds of the Board members during this time.

FINDINGS: COSTS OF SALE

- A sum of $12 million was established to meet the liabilities or outstandings and on-going obligations of TB No1 Limited.
- It is very likely that TB No1 Limited will only require $5 million or thereabouts to meet its financial obligations.
- The balance of the amount in the Trust Account (about $7 million) will be used to further retire state debt.
1. PUBLIC ACCOUNTS COMMITTEE

The Public Accounts Committee Act 1970\(^1\), provides for the establishment of a joint committee, comprising three members from the Legislative Council and three from the House of Assembly.

The function of the Committee is as follows

- The Committee must inquire into, consider and report to the Parliament on any matter referred to the Committee by either House relating to -
  - (a) the management, administration or use of public sector finances; or
  - (b) the accounts of any public authority or other organisation controlled by the State or in which the State has an interest.

- The Committee may inquire into, consider and report to the Parliament on
  - (a) any matter arising in connection with public sector finances that the Committee considers appropriate; and
  - (b) any matter referred to the Committee by the Auditor-General.

The current membership of the Public Accounts Committee (PAC) is

- Hon A W Fletcher MLC
- Hon C L Rattray MLC
- Hon J S Wilkinson MLC
- Mr. K J Bacon (Lyons) MHA
- Mr. R R Cheek MHA
- Hon G H James MHA

The Committee has the power to summon witnesses to appear before it to give evidence and to produce documents and, except where the Committee considers that there is good and sufficient reason to take it in private, all evidence is taken by the Committee in public.

For the purpose of this inquiry the Committee sought and received the assistance of Dr. A McHugh, Auditor-General of Tasmania and wishes to thank him for his expert advice.

2. TRUST BANK - ALLEGATIONS, SPECULATION AND INNUEENDO

During late 1999 individual members of the Public Accounts Committee (PAC) and other southern based members of Parliament and citizens became aware of rumours critical of the management of the former Trust Bank and alleging irregularities in payments made to executive and non executive Directors during the period leading to the change in Chief Executive Officers of the Bank in 1999 and eventually the sale of the Trust Bank late in 1999.

These allegations were brought to the Chairman of the PAC with a request for the PAC to investigate the rumours and allegations.

On 4 February 2000 the Chairman of the PAC wrote to Mr. Loughran, the former Chairman of the Trust Bank seeking advice in regard to aspects of the allegations. A copy of the letter was forwarded to the Treasurer Hon Dr David Crean MLC.

The letter to Mr. Loughran particularly asked for -

1. What amounts have each of the current and former Directors (both executive and non executive) been paid by way of:
   (a) Salary;
   (b) Fees;
   (c) Expenses;
   (d) Superannuation; and
   (e) Other financial or material benefits.

during each of the financial years commencing on 1 July 1995 and ending on 30 June 1999.

2. What salary and other benefits referred to in question (1) were paid to each of the Directors from 1 July 1999 to the date of the completion of the sale or beyond the completion of the sale.

Mr. Loughran replied by telephone call to the Chairman questioning the right of the PAC to inquire into what he claimed to be a private sector institution but at the same time offering to be as co-operative as possible with the PAC in the hope of putting to rest the rumour and innuendo.

3. STATUTORY JURISDICTION

The PAC met on 24 March 2000 and the Chairman outlined his actions in contacting Mr. Loughran. The PAC proceeded to consider both the need to inquire and its power to inquire into and report upon matters relating to the Trust Bank.

3.1 OVERVIEW

There were several factors that marked this issue as different to issues investigated by PACs of the past.

The factors are -

- The genesis of the inquiry was in the community concerns as reported to members of the PAC by Members of Parliament and others.
- The PAC used discretionary powers in considering the issue.
• The PAC chose to call only Mr. Loughran the former Chairman of the Board of Management of Trust Bank to provide evidence to the inquiry.

• The matter was further unusual in that the Trust Bank claimed to be a private sector institution free of links to Government and therefore arguably beyond the purview of the PAC.

Clearly the Trust Bank and its predecessors, the Tasmania Bank and the Savings Bank of Tasmania had all the characteristics of private sector organisations.

The matter of ownership of the various banks established under the Trustee Banks Act 1898 has been considered many times over the years.

The accepted opinion is that the former Launceston Bank for Savings and the former Savings Bank of Tasmania were without owners and this unique situation further applied to the Tasmania Bank and to the Trust Bank up to the time of corporatisation.

When moving the Trust Bank Corporatisation Bill on April 17 1997 the then Premier, the Hon A.M. (Tony) Rundle made it clear that Trust Bank was a 'private' bank operating outside Government control.

The Secretary of the Department of Treasury and Finance Mr. Don Challen was nominated by the Government of the day to be a member of the Board of Tasmania Bank and continued service with the Bank and its successors until the sale of Trust Bank in late 1999.

The General Council of the Trust Bank appointed Mr. Challen to the Board. His role was as an individual with expert knowledge rather than as a representative of Government. His fee for acting as a Director was paid to the Crown in recognition that when working for the Trust Bank he was not available to work for the Crown therefore the Crown should be compensated.

The PAC was strongly of the view that it was in the public interest that the concerns be investigated and reported upon and relied on Section 6(2) of the Act as amended for its jurisdiction.

The Act states

(2) The Committee may inquire into, consider and report to the Parliament on -

(a) any matter arising in connection with public sector finances that the Committee considers appropriate; and

the definition of public sector finances (Section 1A) includes –

any money forming part of, or payable to, the Consolidated Fund or an account in the Special Deposits and Trust Fund; and...
3.2 Trust Bank

Dating from the days of formation the Government of the day has had public money invested in the Trust Bank.

The investment took the form of a $10 million Capital Note which was designed to return a commercial dividend to the State.\(^2\)

Further the Government of the day advanced to the Trust Bank the sum of $25 million in respect of any obligation for bad and doubtful debts of the former Tasmania Bank. The Trust Bank Board and the Colonial Bank agreed in February 2000 that the sale price for the Trust Bank was to be $149.1 million, representing the net asset value of the Bank as at 30 November 1999. The net proceeds of the sale flowed to the Public Account.

3.3 TB No. 1 Limited

TB No.1 Limited is a Government owned corporation with a Board appointed by Government.

TB No.1 Limited is required to meet the State’s obligations under the sale agreement and the Trust Bank Sale Act 1999.

A sum of $12 million, from the initial proceeds of the Trust Bank sale, was deposited in the Special Deposits and Trust Fund to meet the financial obligations of TB No.1 Limited.

Once the process of winding up the remnants of the Trust Bank is completed, TB No.1 Limited will be dissolved in accordance with the Trust Bank Sale Act 1999.

3.4 Conclusion: Statutory Jurisdiction

The PAC has jurisdiction to inquire into both the Trust Bank and TB No. 1 Limited.

4. Scope of the Inquiry

Having reached the decision that it had legislative powers to inquire into the Trust Bank the PAC agreed on 27 March 2000 to open an inquiry into:–

"the matter of payments made to both Executive and Non-Executive Directors and senior staff of the former Trust Bank".

Mr. Loughran’s offer to meet for discussions on the matters raised was accepted and he was invited to give evidence on 31 March 2000.

4.1 SETTING THE PARAMETERS AT PUBLIC HEARING NO. 1

At the hearing on 31 March 2000 the Chairman opened proceedings with a statement aimed at clarifying the role and jurisdiction of the PAC.

4.2 THE CHAIRMAN’S STATEMENT

CHAIRMAN - The Public Accounts Committee suggests that it should not be construed that being at arm’s length from government removes any organisation from the purview of the Parliament. I want to make the point that parties entering into business enterprises or contractual arrangements with the Government or entities being established under statute are dealing with the people of Tasmania, and the Parliament representing the people of Tasmania has an obligation to protect the public interest. The public interest is best protected by having an open, transparent and rigorous process that defends the public’s right to know matters that impact on the security of the public investment or the confidence of the public in the institution.  

4.3 MR. LOUGHRAN’S STATEMENT

Mr. Loughran took the oath and provided an opening statement covering recent Trust Bank history.

During his statement Mr. Loughran referred to a broad range of issues and noting that the scope of the statement was beyond the PAC’s terms of inquiry the Chairman intervened to draw attention to the fact.

CHAIRMAN - Mr Loughran, could I just interpose there, without wanting to spoil your train of thought, your proposition is obviously interesting but it is introducing a much wider range of issues than we initially intend to inquire upon. If the propositions are made, the committee would of course retain the right to inquire further into that broader range of activities.

Mr. Loughran continued with his opening statement.

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3 Chairman, Transcript of Evidence 31 March 2000 Page 1
4 Chairman, Transcript of Evidence 31 March 2000 Page 4

13
4.4 The Question of Confidentiality

Later in the hearing Mr. Loughran raised the issue of the commercial sensitivity of some of the papers he was providing to the PAC.

Mr Loughran - *With the issues of the executive directors, there are some issues of confidentiality and I am bound by legal constraints to ask that that information be given in camera.*

The Chairman responded.

CHAIRMAN - *Mr Loughran, I would need to hear argument. The committee's basic position is that we have a public hearing and the public right to know is powerful in regard this matter. Indeed, it may be in everybody's best interests and in the interests of the institution and the former managers of the institution that this information be made public. However, if you wish to mount argument as to why you should be given the benefit of evidence in camera, then this is your opportunity to mount that argument and the committee will consider it.*

Mr. Loughran submitted his argument.

Mr Loughran - *Let me say at the outset, Mr Chairman, I want to be as cooperative as possible and I have absolutely nothing to hide or be concerned about. I would prefer that the information be public but I am bound by commercial arrangements that were made in confidence - legal arrangements - and I have been advised, first of all, with due respect, that this committee has no jurisdiction over Trust Bank; it does have jurisdiction over TBI. The payments to non-executive directors were made from TBI; the payments to executives were made by Trust Bank. I concur with you, that it is in the interests because I don't want there to be an ongoing debate over this issue, but I would require you to consider in camera whether you want to direct me to provide that information because I will be breaching confidentiality agreements.*

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6 Mr. Loughran, Transcript of Evidence 31 March 2000 Page 6
6 Chairman, Transcript of Evidence 31 March 2000 Page 6
7 Mr. Loughran, Transcript of Evidence 31 March 2000 Page 6


4.5 **The Chairman's Advice**

CHAIRMAN - Mr Loughran, the committee has choices: it could decide to go in camera and take the evidence or it could decide to proceed with this inquiry, an open forum. Or I suppose a third alternative is that members of the committee could decide to establish a select committee of inquiry, which would have much more power to go into the private sector for an investigation. So my judgment is that it is best to proceed in open inquiry and put this information on the table and at least that addresses this right of the public to know; it protects the public interest and it does help to build the confidence in the institution.8

The PAC was of the view that the documentation was important to its consideration of the issues and directed Mr. Loughran to table the documents.

Mr. Loughran did so on the basis that the PAC would classify the documents as commercial-in-confidence.

At a subsequent meeting on 28 August 2000 the matter was again raised and Mr. Loughran agreed that certain documents which had been tabled in confidence could be quoted in the report but requested that details of Mr. Airey's service agreement and addenda not be made public.

The PAC has agreed to that request.

5 **Scope of the Inquiry: Further Consideration**

5.1 **Overview**

The PAC decided that as a result of additional matters raised by Mr. Loughran at the first meeting further consideration should be given to the scope of the inquiry.

By 27 April 2000 the range of allegations made to Members of Parliament and reported upon in the media was quite wide.

The allegations not only challenged the wisdom and legality of payments to certain parties, but cast doubts about the management of the asset acquisition program and further challenged accounting and audit practice.

Further allegations were reported to Tasmania Police for investigation.

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8 Chairman, Transcript of Evidence 31 March 2000 Page 7
The reasons for extending the inquiry were built around the public right to know whether or not the Board of Trust Bank was following due process in meeting its obligations.

The PAC was, however, unanimously of the opinion that there remained a need to contain the inquiry within defined boundaries.

The reasons for containing the inquiry were -

- If any wrongdoing was identified it would not alter the status quo nor lead to monetary benefits to offset the cost of an expanded inquiry.
- The paper trail left by various mergers, takeovers and sales was likely to be very costly to trace.
- Key executive personnel were no longer employed, were unlikely to be cooperative and the cost of requiring their attendance at the inquiry would likely be high.
- The passage of time further added to the difficulty and cost of chasing the paper trail.
- The complexity of issues raised would likely require a research team with legal, accounting and auditing skills to professionally test the allegations.
- Matters raised by Senator Murphy and claimed to be of a criminal nature had been referred to Tasmania Police for their investigation.

The PAC did however have continuing concerns about the processes leading to the sale decision and the payments ultimately made to key personnel.

The PAC sought to protect the public's right to know if the processes were sound and whether the payments had any material effect on the quantum of the funds that eventually flowed to the Crown for the reduction of State debt.

5.2 CONCLUSION: EXTENDING THE TERMS OF REFERENCE

The PAC reached the conclusion that it would extend its inquiry to consider matters raised by Mr. Loughran in his statement to the PAC at the first meeting.

The PAC decided against using the wisdom of hindsight to second-guess the decisions of the Board of Trust Bank.

Rather it chose to confine the scope of its expanded inquiry to an in depth examination of the decision making processes in several key issues.

The key issues identified by the PAC were:-

- Payments associated with the retirement of Mr. Paul Kemp.
- The recruitment, appointment and termination of Mr. D Airey's employment as General Manager and Chief Executive Officer.
- The payments made to non-executive directors of the former Trust Bank.
• The process leading to the acquisition of the technology platform.

• The financial reporting information that was available to directors during the critical period December 1998 until April 1999.

• Matters related to the cost of sale of the Trust Bank.

The PAC's rationale was that if the process adopted by the Board in reaching a decision on these matters was sound, then the Board was vindicated in making the decision even if others, having the benefit of hindsight, believed that the decision was wrong.

Accordingly the PAC resolved on 27 April 2000 that the current inquiry be expanded.

"Resolved, That the Committee expand the inquiry into payments made to both Executive and Non-Executive Directors and senior staff of the former Trust Bank to include consideration of the management of the Trust Bank in relation to the purchase and commissioning of a new computer system and related matters."

6. **THE SECOND REQUEST OF MR. LOUGHRAN**

With the aim of exploring and making a judgement about the validity of the decision making processes the PAC agreed to call Mr. Loughran to give further evidence.

The PAC wrote to Mr. Loughran on 3 May 2000 outlining the terms of the expanded inquiry and asking for specific information.

The letter to Mr. Loughran is appended.

Mr. Loughran agreed to meet the PAC for a second time and the meeting was arranged for 19 May 2000.

7. **MR. P KEMP: RETIREMENT**

7.1 **OVERVIEW**

Mr. Paul Kemp was appointed Manager of the Savings Bank of Tasmania in March 1987 and Managing Director of Trust Bank in March 1991.

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9 Minutes of PAC meeting 27 April 2000
He voluntarily retired from the Trust Bank on 30 April 1999 and received a termination payment of $548 285. The components of the termination payment were.¹⁰

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<td>Salary &amp; Director’s fees</td>
<td>$253 313</td>
</tr>
<tr>
<td>Superannuation</td>
<td>$177 821</td>
</tr>
<tr>
<td>Unused leave</td>
<td>$117 151</td>
</tr>
</tbody>
</table>

Further to these entitlements Mr. Kemp received a special gratuity payment of $105 299.

The total collected by Mr. Kemp was $653 584.

### 7.2 TERMINATION PAYMENTS

The PAC had a particular interest in the termination payment to Mr. Kemp.

At the first meeting with Mr. Loughran the PAC was advised.

**MR. LOUGHRAN** - *The payment included an amount of $105 299 being a special retirement gratuity calculated on the basis that Mr. Kemp had qualified under rule 23 of the Employees Gratuity Fund.*¹¹

The Staff Gratuity Fund,¹² Rule 23, applies to any employee of the Trust Bank with a record of 30 years service. Mr. Kemp had 14 years service but because the Board considered his service as worthy of special recognition he was deemed to have had 30 years service. It was competent of the Board to make this decision and Mr. Loughran justified it on the following basis.

**MR. LOUGHRAN** - *In Mercer’s recommendation they took into consideration that Mr Kemp had originally desired to work to age 57; they stated to the board it is quite common for additional benefits to be provided to a retiring chief executive and, after a consideration of various options, the board determined to provide a benefit as though Mr Kemp was a member of the staff gratuity scheme.*¹³

This issue was reported in the press and the PAC received a letter from Mr. R Jessup dated 28 June 2000 alleging the Board had acted improperly in making a payment from the Staff Gratuity Fund.

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¹⁰ Remuneration, Retirement and Termination Arrangements tabled 31 March 2000
¹¹ Mr Loughran Transcript of Evidence 31 March 2000 Page 9
¹² Staff Gratuity Payments. Tabled 19 May 2000
¹³ Mr. Loughran, Transcript of Evidence 19 May 2000 Page 7
At the subsequent meeting Mr. Loughran corrected his previous statement as follows.

MR. LOUGHRAN - Mr. Chairman, at the previous hearing, I did say, I think, that the payment was made from the staff gratuity scheme; that was not so. That was from my recollection, but on research I note that it was as though Mr. Kemp was a member of the gratuity fund. The amount of $105 299 was agreed after the advice from Mercer’s and after calculations by the Bank’s HR and remuneration staff in cooperation with the board secretary.14

In response to questions about the competency of the Board to approve such a payment Mr. Loughran explained.

MR. LOUGHRAN - You asked about the authority for the board to make this payment. The authority for the board to make the payment was advised to the Board in a Board note from the Board secretary as having the power to make ex gratia payments to staff. He (Mr. Kemp) did not qualify under rule 23, which is the rule relating to gratuity payments, within the Trustee Banks Act 1985, section 14(3)(k). This power has been used by the board on a number of occasions in the past and in the legislation it says that, 'The board has the right and may do all such things as it thinks proper for the profitability and good management of the bank.15

7.3 THE SERVICE AGREEMENT

The PAC was confused by the presentation of separate contracts each stated to be the Trust Bank’s service agreement with Mr. Kemp.

It appears obvious that the contract submitted on 12 April 2000 and noted by Mr. Loughran as (a) Employment Contract of Mr. Kemp with the notation that ‘A copy of this agreement that I believe to be the final version has been provided’ was devoid of detail.

The PAC was interested in pursuing this matter because Mr. Kemp’s termination payments were based on his individual service to the Trust Bank and the initial contract provided to the PAC indicated that he may have been the employee of a private company having a service agreement with the Trust Bank.

14 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 7
15 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 7
The Chairman raised the issue.

CHAIRMAN.- We were provided at the last sitting with a contract on which stamp duty has been assessed, that is completely different from the contract of the agreement dated May 1996, which is the contract presented by Mr Loughran this morning.\textsuperscript{16}

Mr. Loughran also stated his confusion.

Mr. LOUGHRAN. -I don't understand that, Mr Chairman. All I know is when I researched Paul Kemp's file I found the latest contract that he had, which was 16 May 1996, and I have brought that to you. What you received before I can't comment on, to be honest, I don't know. I thought all you received before was a page with some outlines on it with no content. Is that right?\textsuperscript{17}

It was not right. The document originally submitted by Mr. Loughran commenced 'THIS SERVICE AGREEMENT is made on 1 March 1995'. It comprised 9 pages, had a schedule attached and was assessed for Stamp Duty in Victoria on 21 March 1995.

The agreement was between a party unknown (name whited out) and the Executive named in the schedule (Clause 6.1) referred to the Executive being a member of a superannuation plan (the name of the Plan has been whited out) and all details of the schedule have been whited out.

The use of a consulting company, with a nominated executive person to carry out the duties for the employer is a relatively common business arrangement designed to minimise the costs of doing business.

The PAC notes that Mr. Kemp's Service Agreement dated 16 May 1996 (the second submitted) superseded the document previously provided.

Mr. Loughran later assured the PAC that Mr. Kemp was always employed in the normal sense as an individual.

MR. LOUGHRAN - One question you asked me this morning was Paul Kemp ever employed other than as an individual. I am informed by the bank that he wasn't; he was always employed in the normal sense as an individual.\textsuperscript{18}

\textsuperscript{16} Chairman, Transcript of Evidence 19 May 2000 Page 18
\textsuperscript{17} Mr. Loughrar, Transcript of Evidence 19 May 2000 Page 18
\textsuperscript{18} Mr. Loughrar, Transcript of Evidence 19 May 2000 Page 18
7.4 FINDINGS: MR. KEMP

- The payment to Mr. P. Kemp representing salary and Director's fees, superannuation and unused leave was according to established arrangements.

- The Board had the authority to approve an ex gratia payment of $105 299 to Mr. Kemp.

- The ex gratia payment to Mr. Kemp was provided on the basis that the Board believed that Mr. Kemp's 14 years of service at senior executive manager level equated to 30 years of service given to the Bank by any other employee.

- Rule 23 of the Employees Gratuity Fund was the basis for determining the quantum of the payment to Mr. Kemp. Advice was taken from the Actuary, the Bank's HR and Remuneration staff and the Board Secretary prior to the decision being made.

- While the evidence was not conclusive the PAC accepts that the Trust Bank employed Mr. P. Kemp as an individual employee in the general understanding of the term.

8. MRAIREY: APPOINTMENT AND RETIREMENT

8.1 APPOINTMENT

As mentioned in an earlier section of this report the Chairman of the PAC was moved to seek preliminary advice from Mr. Loughran because of the concerns being expressed to him and other Members of the PAC about payments made to former members of the Trust Bank Board.

The PAC became interested in the quantum and justification of the payment to Mr. Airey and invited Mr. Loughran to discuss the matter.

During the first hearing Mr. Loughran advised the PAC of the justification for appointing Mr. Airey to a three-year term with options.

MR. LOUGHRAN - We were negotiating with Mr. Airey in December, at a time I've already conceded that we were having difficulty with the monthly profit and loss.19

19 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 45
Chart 1 prepared from data available in the various annual reports of the Trust Bank indicates that post 1995 the after tax profit was trending down at a significant rate.

Despite this trend the Board of the Trust Bank remained confident and was optimistic when recruiting Mr. Airey.

December was the period when the new technology was operating, the Board was concerned about aspects of the management reports being submitted but the Board remained confident about the future of Trust Bank.

MR. LOUGHRAN - ..........the information that the board was receiving right up until December in the previous year was that the Bank was trading profitably, albeit at a very low profit, and really probably an unsustainable profit into the future but with the potential for improvement.²⁰

During the next period leading to the signing of the Service Agreement dated 30 March 1999 and the commencement of duties by Mr. Airey on the 1 April 2000 the financial reports available to the Board showed a significant deterioration in after tax profit.

The financial information coming to the Trust Bank Board in the 6 month period ending April 1999, was significantly different to the information available to the Trust Bank Board in the period leading up to December 1998.

²⁰ Mr. Loughran, Transcript of Evidence 31 March 2000 Page 19
Chart 2 shows the rapid decline in profitability of the Trust Bank during the time that the Remuneration Committee was negotiating with Mr. Airey.

Mr. Loughran indicated in the following statement that there may have been a disbelief by some Board members of the financial status reports being produced by the new technology for the period until the reports were audited.

**MR. LOUGHRAN** - but when the new computer technology platform came on board, the figures that were revealed were quite different and we had them obviously audited and it was obvious that the figures - I don't know to this day why the figures were different, but we had to act very quickly - and that took place after the Airey contract had been negotiated.\(^2\)

It is reasonable to assume that the Board of Trust Bank was receiving the financial status reports a month in arrears and that by the time the trend line was clear the negotiations with Mr. Airey were completed.

**MR. LOUGHRAN** - So in fact Airey, when he came on board, was assuming that the bank was profitable, had a reasonable profit and it could be built on, and the facts, as they unfolded, were different.\(^3\)

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\(^2\) Mr. Loughran, Transcript of Evidence 31 March 2000 Page 19
\(^3\) Mr. Loughran, Transcript of Evidence 31 March 2000 Page 19
And further -

MR. LOUGHRAN - Soon after the managing director commenced employment it was discovered that the projected profitability of the bank would be considerably less than had been represented during the recruitment process. This led the board to re-evaluate the future options for the bank and the decision by the Board to pursue up to a 100 per cent sale.\textsuperscript{23}

Given the information available to it the Board’s advice to Mr. Airey during the recruitment stage may well have been overly optimistic. The statements are important in a later consideration of the decision to compensate Mr. Airey for ‘loss of opportunity’.

In any event Mr. Loughran pointed out in his letter of 5 June 2000 -

MR. LOUGHRAN - In the evidence I gave on 31 March 2000 I agreed the uncertainty in monthly profit and loss for a short period after the installation of new technology, but which coincided with the time of negotiations with Mr. Airey was not helpful. However, in reality it did not change anything of substance. We would always have had to arrange a replacement for Mr. Kemp and it was vital to engage the best possible replacement with our endeavour to attract a Strategic Partner or investors for a public float. Mr. Airey or any other quality candidate would not have joined the Bank, particularly in the midst of a corporatisation process, unless an appropriate contract with incentives was available.\textsuperscript{24}

If this was the scenario Mr. Airey was in a position of strength to negotiate and renegotiate his contract with the Trust Bank Board.

8.2\hspace{1em}Elements of Mr. Airey’s Service Agreement

At the meeting of 31 March 2000 some discussion took place regarding the tension between the Trust Bank Board’s requirement to protect confidentiality and the PAC’s requirement to serve the ‘public interest’.

After a consideration of the matter Mr. Loughran made Mr. Airey’s Service Agreement dated 30 March 1999 available to the PAC.

\textsuperscript{23} Mr. Loughran, Transcript of Evidence 19 May 2000 Page
\textsuperscript{24} Mr. Loughran, Letter to PAC 5 June 2000
The PAC acknowledged the Trust Bank Board’s undertaking to preserve confidentiality in relation to conditions of Mr. Airey’s employment and termination and agreed that the documents would be considered ‘in camera’.

Following a consideration of the matter ‘in camera’ and a further discussion with Mr. Loughran and others at the meeting of 28 August 2000 the PAC agreed that Mr. Airey’s Service Agreement and Addenda would not be published.

The PAC retained the right to consider the document as evidence and to paraphrase details of its contents for the report.

While not attempting to provide all the detail of Mr. Airey’s contract the PAC needs to identify the essential elements.

The initial term of the Agreement was for three years from 31 March 1999.

Remuneration included an incentive portion plus stock options in the event of a public float and in the event of there not being a public float ‘synthetic stock options’ would be substituted.

Within three months of commencing duties with Trust Bank Mr. Airey and the Board agreed on the need to add an addendum to his Service Agreement.

The Addendum clarified the role and duties of the CEO and introduced termination rights in the event of a ‘fundamental change’. Such a change was taken to have occurred when Mr. Airey’s status, duties and roles were diminished without his consent. This had the effect of widening the circumstances in which Mr. Airey could access a termination benefit and potentially increased substantially the period of time for which the compensation was calculated.

In the event of ‘fundamental change’ Mr. Airey was to receive a lump sum consisting of total remuneration including the value of pro rata bonuses and stock or synthetic stock option entitlements at maximum levels.
During his first meeting with the PAC Mr. Loughran argued that the Service Agreement Addendum approved by the Board on 29 June 1999 was of no substance.

MR. LOUGHRAN - The contract wasn't renegotiated, no I said to you there were some slight amendments but they would be very technical in detail and I would be very happy to provide them to you, but the substance of the contract was not amended.\textsuperscript{25}

At the meeting of 28 August 2000 Mr. Loughran was asked to reconsider that advice. In evidence he stated that in his opinion the great substance of the Service Agreement was not changed by the Addenda. He agreed that in relation to the matters of roles and duties and further in relation to the notion of 'fundamental change' and the benefits on termination in the event of 'fundamental change' there had been substance.

The PAC has already heard that Mr. Airey was in a position of strength when negotiating his Service Agreement dated 30 March 1999 and therefore exerted similar power when negotiating the Addendum to his Service Agreement approved by the Board on 29 June 1999.

8.3 \textbf{The Stock Option}

An important tenet of Mr. Airey's Service Agreement was the provision for a 'stock option' or in the event of the Trust Bank not moving to a public float by 1 September 1999, a 'synthetic stock' option.

The option provided that if the Trust Bank Board successfully negotiated with a 49% partner and the business was floated, Mr. Airey and others would be offered stock at favourable rates.

The incentive was to reflect Mr. Airey's contribution to the improvement in the value of the Trust Bank.

An important component of the termination payment to Mr. Airey was the $1.4 million value placed on Mr. Airey's synthetic stock option.

The Committee sought to explore the potential extent of the 'synthetic stock option' and the reasons given for a variation in the service agreement.

\textsuperscript{25} Mr. Loughran, Transcript of Evidence 31 March 2000 Page 12
8.4 A Change in Strategy

Immediately Mr. Airey commenced with the Trust Bank he was instructed by the Board to review the financial viability of the Trust Bank.

MR. LOUGHRAN - ...the board asked the new CEO to place emphasis on the following: the future profit projections, the future capital requirements, the prospects of finding an equity partner and the long-term strategic position of the bank.\(^{25}\)

His report was fundamental in changing the Board’s attitude to its long-term sustainability.

Mr. Loughran agreed in evidence that it was Mr. Airey who recommended the 100% sale and justified Mr. Airey’s position by stating that there was additional overwhelming evidence including that from consultants Price Waterhouse, Salomon Smith Barney and accounting advice that the sale option was best.

The PAC accepts the proposition that by July/August 1999 the weight of evidence supported the 100% sale of the Trust Bank.

The Board having reached a decision that the 100% sale of the Trust Bank was the only option available to it was then forced to consider the impact on Mr. Airey of such an outcome.

It was about this time that Mr. Airey lodged a claim for his loss of opportunity to improve the Bank and thus qualify for stock options or ‘synthetic stock options’ and other ‘at risk’ benefits.

Clearly the Board needed the strength, acumen, expertise and cooperation of Mr. Airey to facilitate a sale.

MR. LOUGHRAN - .....It is important to achieve a prompt resolution so that the managing director can concentrate his efforts and move forward cooperatively to achieve the best outcome for all stakeholders.\(^{27}\)

The choices available to the Board were very limited.

They could meet their legal obligation under the Service Agreement dated 30 March 1999 or they could meet Mr. Airey’s claim.

\(^{25}\) Mr. Loughran, Transcript of Evidence 19 May 2000 Page 52
\(^{27}\) Mr. Loughran, Transcript of Evidence 19 May 2000
8.5 THE NEED FOR PAYMENT UNDER THE SERVICE AGREEMENT—A LEGAL ARGUMENT

The Board agreed to seek advice in regards the payment of a special benefit to Mr. Airey based on his role in facilitating a change in shareholding.

It sought initial advice from Sibson & Company.

...I am pleased to outline our proposed methodology for assisting Trust Bank evaluate the potential nature and level of incentives to be paid to the Managing Director, based on his role in facilitating a change in shareholding. 28

Sibson & Company went on to outline a proposed methodology.

The Bank did not proceed with the Sibson & Company proposal.

The Trust Bank Board, or its representatives, also negotiated with Remuneration Planning Corporation (RPC) and following a number of meetings, RPC reported back to the Board with a range of options in answer to its brief.

The PAC has perused the RPC Report dated 9 September 1999.

Again the PAC notes that the consideration has moved from a payment to Mr. Airey on the basis of his Service Agreement as amended to a consideration of a special payment based on the proposition that Mr. Airey has lost the opportunity to qualify for increased benefits.

Many factors about the nature of the times suggest to the PAC that there was considerable tension between Mr. Airey and members of the Board. The Bank was in crisis, public confidence was waning and Mr. Airey had lodged a claim for loss of opportunity.

The Report of RPC provided to the PAC by Mr. Loughran advised the Board of a range of options but disclaimed any capacity to advise in regard to the legal obligation of the Bank to meet a package designed to compensate Mr. Airey for the ‘loss of opportunity’.

It should be noted that the report does not deal with the validity of the claim and whether any legal obligation to make the payment exists. RPC noted -

"These issues are beyond the scope of our advice" 29

28 Sibson & Company Advice 3 August 1999 (Confidential Document)
29 RPC Report (Confidential Document)
Mr. Loughran acknowledged that fact in evidence.

**MR. LOUGHRAN** - The report from RPC recommended the board receive separate legal advice with a legal obligation to pay compensation. The advice was received from Richard Tracy QC and confirms an obligation for the bank to compensate.  

R. R. S. Tracy QC advised

_In these circumstances I find it difficult to understand how Mr. Airey asserts he will have been deprived of the opportunity to avail himself of synthetic stock options and the 'at risk' portion of his incentive package. Under the agreement, as amended, the monetary value of both these benefits would be brought into account in determining the sum he was to be paid upon termination of his employment under Clause 11 (c). These benefits are no doubt quantifiable upon expert advice._

Mr. Loughran’s initial advice to the PAC attempted to link the Tracy QC advice to the RPC report options for compensating for ‘loss of opportunity’.

However at the meeting of 28 August 2000 both Mr. Loughran and Mr. A Kemp conceded that there was no legal advice supporting the obligation of the Trust Bank to pay compensation for loss of opportunity as quantified by RPC.

**Mr KEMP** - Chairman, put very simply, we were faced with a set of circumstances where we did not want to go the route of attempting to test the legal situation in the court because at the end of the day that's the only place you can really test it. We acted on all the best advice we could get and made a commercial decision which I believe was a sound commercial decision in all the circumstances.

**CHAIRMAN** - ............... I think you are agreeing with the conclusion of the committee that whilst there was no binding legal opinion that said, 'You must pay for this loss of opportunity', the overriding imperative was the commercial reality and the commercial reality said, 'We have no choice in this matter.........

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30 Mr. Loughran, Transcript of Evidence 31 March 2000 Page 5  
31 RRS Tracey QC Advice Clause 10 (Confidential Document)  
32 Mr A Kemp, Evidence 28 August 2000 Page 3 ('in camera')
Mr. Loughran - I think you're right. We've had that discussions ourselves and in some ways it's easier after several months when you're not in the heat of the moment. I see it clearer now than I did then. But I don't think it's quite as straightforward as that and I might ask Andrew or Val to comment, if you wouldn't mind. In his report he says, 'Your responsibility is to pay out as per the contract' which would have meant paying out synthetic options which in reality, because they'd had no time to travel, had no value. So what he is saying in clause 11 is, these matters, if you look at it, are quantifiable upon expert advice. So we took expert advice and they did quantify the value of the options, what they might have been.

Chairman - Yes, but that's the very concern that the committee has in that you are saying, RPC says take legal advice, Tracey says you can quantify them and you say to me RPC has quantified them - we're not talking about the same thing here. We're not talking about the same thing at all. RPC has quantified the loss of opportunity and Tracey is saying the legal obligations under your contract can be easily quantified and that's a separate thing altogether in the mind of the committee, and you need to convince us that that's not so.

Mr. Kemp - Mr Chairman, I think you've come to absolutely the right conclusion because when we were looking at this we were taking all the factors into account and we were making a commercial decision. We're not trying to say that we stand entirely on a legal position and we only would have taken that decision if the legal advice had told us we had to, the commercial imperative told us this was the wise and sensible course of events. We agonised over it, I can tell you, for a long period of time to get it right and I believe we got it right.33

The PAC recognises that while the Trust Bank Board may not have had a legal obligation to provide the compensation for 'loss of opportunity' it does clearly recognise that at the time other factors had far greater importance.

Given the optimistic advice provided to Mr. Airey during the recruitment stage and referred to earlier in this report it may be that the Trust Bank Board felt a moral obligation to honour the intent of the service agreement. More importantly and certainly more likely given Mr. Loughran's many statements in evidence, the commercial imperative was dominant over both the legal and moral requirements.

33 Transcript of Evidence 28 August 2000 Page 6 (in camera)
Several times in his letter of 5 June 2000 Mr. Loughran\(^{34}\) identifies the crisis.

‘There had been a gradual and continual deterioration and in the previous financial year the Bank’s underlying profit had substantially declined. Over several months, due to a number of factors, the Bank had been unable to achieve its budgeted objectives’.

‘As events unfolded, the Bank’s profit continued to decline between October to April’.

‘The most significant factors effecting the Bank and the profit deterioration, both in the previous financial year and in the first half of 1997/98, were the declining interest margins and increased technology costs. Without a capital base, the Bank had to rely on expensive wholesale funding, and with increased competition from Banking and non-Bank sources, it was evident interest margins would not improve’.

‘Whereas it had been predicted that the new technology would result in long-term cost savings, the short-term problems with the system did not allow these savings to have a positive impact’.

‘The advice received in the reports confirmed a continuation of poor profit and inadequate liquidity and the potential for a credit down-grade below investment grade’.

‘It should not go without notice that had the Bank and the Board not acted decisively, the potential for a credit down-grade could have brought about significant risk and achieved a less attractive price’.

The PAC has sought to understand the absolute pressure facing the Board of the Trust Bank at this time. The long term problems emanating from the Reserve Bank, the Australian Prudential Regulation Authority and the ratings agencies were followed in quick succession by a huge blow out in the cost of the information technology upgrade, deteriorating financial results and the diminishing prospect of a strategic alliance.

On top of all this just as a ‘white knight’ in the guise of the Colonial Bank is identified Mr. Airey’s claim for ‘loss of opportunity’ is put before it.

The PAC is of the opinion that both Mr. Airey and the Remuneration Committee of the Trust Bank Board were aware that Mr. Airey’s cooperation and total commitment was required if a successful sale to Colonial was to be achieved.

\(^{34}\) Mr Loughran, Letter dated 5 June 2000
It was at this time that Mr. Airey’s negotiating strength reached its highest point.

It is unthinkable that the Board and the CEO could fall out at this time but the PAC is convinced that Mr. Airey seized the moment and demanded of the Trust Bank a further financial incentive in the form of compensation for loss of opportunity.

The Board’s immediate commercial imperative was to overcome the differences with Mr. Airey and then to move cooperatively to a sale.

MR. LOUGHRAN- ‘but without Airey’s contacts and connections I don’t believe we would have got the outcome we did’.  

8.6 QUANTIFYING THE OPTIONS

Having decided to compensate for ‘loss of opportunity’ the challenge for the Board was to agree on the quantum of the compensation.

MR. LOUGHRAN - ........In determining an outcome the board needs to consider the question of fairness to each of the parties and should take into consideration what was contemplated at the time of recruitment and the changed circumstances of the bank. Whatever is decided must meet the criteria of being appropriate compensation, to be reasonable, taking into consideration what was contemplated by both parties to be defensible, recognising that we are dealing with a community asset, and acceptable for both parties.

Mr. Loughran explained that the Remuneration Committee of the Board carried out the negotiations with Mr. Airey. Mr. Loughran was a member of that Committee.

MR. LOUGHRAN - No. The remuneration committee negotiated the outcome; they recommended to the full board and the full board made the decision, and I think about September –

The Remuneration Committee of the Trust Bank Board used the RPC report presented to the Board on 9 September 1999, as the basis for its consideration.

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35 Mr. Loughran, Transcript of Evidence 31 March 2000 Page 15
36 Mr. Loughran, Letter dated 5 June 2000

32
RPC used its corporate business experience to recommend compensation within the range of $1.4m to $2.5m for Mr. Airey’s loss of opportunity to benefit from synthetic stock options.

The Trust Bank settled on a value of $1.4 million to be paid in 3 years time but discounted the sum back to present day values for payment on the sale of the Trust Bank.

MR. LOUGHRAN ———- Whereas we agreed on a settlement of 1.4, we discounted it back to present day value and agreed to increase it at 5.25 per cent per annum. So it came up at 1.2; if he’d gone the three-year period, it would have got to 1.4.\(^{37}\)

The PAC queried many of the assumptions used by RPC, including the sale price of the Trust Bank and the 15% agreed rate of growth for the Trust Bank, used in reaching its conclusions.

The Service Agreement Second Addendum between Trust Bank and Mr. Airey signed on 4 November 1999 agreed to put a value on the synthetic stock options as at 1 September 1999 of $1,200,00.00.

The PAC is of the opinion that the $1.2 million dollars is not the value of the synthetic stock options as at 1 September 1999. Rather the $1.2 million is the valuation of Mr. Airey’s loss of opportunity to earn those options over time and therefore represents a payment over and above the strict legal entitlement under the Service Agreement as amended.

8.7 FINDINGS: MR. AIREY

- The situation outlined in Mr. Loughran’s letter of 5 June 2000 to the extent that the ‘Bank needed to arrange succession and secure strong leadership for it to move forward’ to a strategic partnership and/or a public float’, was the reality.
- As a result of the circumstances Mr. Airey was in a position of strength when negotiating his conditions with the Trust Bank Board and seized every opportunity to further his own benefit.
- There was nothing irregular in the appointment of Mr. Airey and any businessman of experience exercising similar bargaining power would have used this strength to deliver a favourable outcome.
- There was no evidence to suggest there was a legal obligation to pay compensation for ‘loss of opportunity’ to Mr. Airey.
- The Trust Bank’s legal obligation was to meet the terms and conditions of the service agreement as amended.

\(^{37}\) Mr. Loughran, Transcript of Evidence 19 May 2000 Page 61
• Given the limited time available to Mr. Airey to improve the performance of the Trust Bank the maximum value of those ‘at risk’ and ‘synthetic stock options’ elements of the Total Remuneration package obligations at the time of sale was likely to be a relatively insignificant amount.

• The valuation documented in the Service Agreement Second Addendum was attributed to the synthetic stock option when in fact the valuation should be for the ‘loss of opportunity’ to earn those options over time.

• The payment of $1.2 million was over and above that which could be attributed to the Trust Bank’s obligations under the Service Agreement dated 31 March 1999 as amended.

• The commercial reality of the time gave the Trust Bank Board little option but to negotiate a compensation package for Mr. Airey.

• The outcomes of the negotiations, which paved the way to a successful sale of the asset, was in the best interests of all the stakeholders.

9. PAYMENTS TO NON-EXECUTIVE DIRECTORS

9.1 OVERVIEW

The General Council, an advisory body of the Trust Bank and the Savings Bank before it, elected the non-executive members to the Board of the Bank. The Board in turn was charged with appointing members of General Council. The closed circuit nature of the process of appointing General Council and Board members may not have been in the best interests of the bank.

The question that many would like answered is whether the loss of profitability of the Trust Bank was brought about by structural inefficiencies that eventually robbed the Trust Bank of its competitiveness or was it a matter of poor decision making at a senior level. The quality of the managers of the Trust Bank and the reasons for its rise and fall may never be fully determined.

9.2 DIRECTORS REMUNERATION

The total remuneration of the Directors of Trust Bank for the year ended 31 August 1999 was $1.044 million, up from $608,000 one year earlier. The reasons for the increased amount is the inclusion of special payments to Mr. P. Kemp and Mr. D. Airey

The remuneration of Directors consists of fees (or salary in the case of the Managing Director) and Trust Bank's obligations under the Commonwealth's Superannuation Guarantee legislation.

Mr. Loughran provided the following information in respect of Directors’ remuneration for the period 1 September 1998 to 31 August 1999.
Directors' Remuneration 1999

<table>
<thead>
<tr>
<th>Director</th>
<th>Director Fee $</th>
<th>Superannuation $</th>
<th>Total Remuneration $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandler, J D</td>
<td>36 800</td>
<td>2 576</td>
<td>39 376</td>
</tr>
<tr>
<td>Fitzgerald, S H</td>
<td>36 800</td>
<td>2 576</td>
<td>39 376</td>
</tr>
<tr>
<td>Best, E</td>
<td>28 200</td>
<td>1 974</td>
<td>30 174</td>
</tr>
<tr>
<td>Loughran, G N</td>
<td>52 900</td>
<td>3 703</td>
<td>56 603</td>
</tr>
<tr>
<td>Holyman, R</td>
<td>28 200</td>
<td>1 974</td>
<td>30 174</td>
</tr>
<tr>
<td>Challen, D W</td>
<td>28 200</td>
<td>1 974</td>
<td>30 174</td>
</tr>
<tr>
<td>Kemp, A</td>
<td>30 600</td>
<td>2 142</td>
<td>32 742</td>
</tr>
<tr>
<td>Ranicar, A P</td>
<td>28 200</td>
<td>1 974</td>
<td>30 174</td>
</tr>
<tr>
<td>Smith, V R</td>
<td>28 200</td>
<td>1 974</td>
<td>30 174</td>
</tr>
<tr>
<td>Kemp, P</td>
<td>370 464*</td>
<td>177 821^</td>
<td>548 285</td>
</tr>
<tr>
<td>Airey, DML</td>
<td>177 120^</td>
<td></td>
<td>177 120</td>
</tr>
</tbody>
</table>

Total Directors' Remuneration 1 September 1998 to 31 August 1999 | $1.044 million

* Includes $117 151 in unused leave payments.
^Includes $105 299 in a special gratuity payment to be added to superannuation entitlement.
# Represents partial year payment following commencement with Trust Bank based on an annual salary and superannuation entitlement of $425 000.

Further to the above payments all Directors retired on the sale of the bank and became entitled to Director's retirement Benefits as itemised in the following table.

<table>
<thead>
<tr>
<th>Director</th>
<th>Retirement Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smith*</td>
<td>$0.00</td>
</tr>
<tr>
<td>Chandler</td>
<td>$93 930.77</td>
</tr>
<tr>
<td>Fitzgerald</td>
<td>$95 291.67</td>
</tr>
<tr>
<td>Best</td>
<td>$71 886.45</td>
</tr>
<tr>
<td>Holyman</td>
<td>$59 598.01</td>
</tr>
<tr>
<td>Loughran</td>
<td>$115 043.56</td>
</tr>
<tr>
<td>Challen**</td>
<td>$45 436.81</td>
</tr>
<tr>
<td>Ranicar*</td>
<td>$0.00</td>
</tr>
<tr>
<td>Kemp</td>
<td>$36 562.45</td>
</tr>
<tr>
<td>Total</td>
<td>$515 749.72</td>
</tr>
</tbody>
</table>

*Mr. Smith and Mr. Ranicar received compulsory superannuation guarantee charge minimum superannuation in conjunction with all directors.

** The benefit of Mr. Challen's payment has gone to the Department of Treasury and Finance.
9.3 FINDINGS: NON-EXECUTIVE DIRECTORS

- The 1999 payment was inflated by the inclusion of termination payments to Mr. Paul Kemp and Mr. David Airey.
- Non-Executive Directors were paid according to their entitlements.
- Mr. Don Challen’s fees and retirement allowances were paid directly to the Consolidated Fund to compensate for his absence from Crown work.
- Payments made on the retirement of Non Executive Board members were according to longstanding Board Rules.

10. THE TECHNOLOGY PLATFORM

10.1 OVERVIEW

The PAC was concerned with allegations made concerning the process for acquiring and commissioning the technology platform.

Members of Parliament generally have been aware since the days of early negotiations between key stakeholders for the establishment of a state bank that the several institutions have been very protective of the quality of the IT available to their particular institution.

The PAC received correspondence from Mr. Trevor Yaxley relating to his experience with the efficiency and operations of the computer systems of the various Bank’s during the period of mergers and take-overs. The advice was noted but considered to be outside the PAC’s terms of reference.

Management advised the Board in 1994 that -

MR. LOUGHRAIN - ......In 1994 management advised the board that the information technology platform was increasingly unsuitable, manifesting itself in a number of ways. The software was becoming old and increasingly more expensive and difficult to update. The hardware was becoming old and unsuitable with crashes becoming more frequent. Future needs of the bank to cope with the delivery of new and more sophisticated products, ability to cope with the uniform consumer credit code of practice, flexibility to allow for expansion of markets, the need to be at the forefront of a rapidly changing information technology banking sector rather than being old fashioned and outdated made it imperative to seek the best and most suitable IT package.38

38 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 27
In 1994 the Trust Bank Board was under pressure from the Reserve Bank to further upgrade its technology platform.

MR. LOUGHRAN - .......Just to advise you that a report from the Reserve Bank on 21 December 1994 stated that IT development is justifiably a matter of priority with the bank and will play a critical role on the bank's ability to remain competitive. On 25 January a specialist IT manager was engaged to manage the bank's transition into a new IT platform. On 22 March 1995 the Reserve Bank again reported over a number of years that IT has been an area of concern at Trust Bank and the issue needs to be dealt with. 39

The process of replacement commenced.

MR. LOUGHRAN - Chairman, only this week I've been able to ascertain that Deloittes Tomatsu were involved in that process, Ernst and Young were both involved. Deloittes, I am advised, were not accepted due to cost. Ernst and Young were not accepted due to the fact that some of their senior people were not going to be available for the entirety of the project so Price Waterhouse was selected to advise the bank on the best possible solution. I have with me but I don't intend to tender it because it is a document from another company and I don't think it's appropriate to do so but the final recommendation was made to the board in November 1995 to proceed. 40

Mr. Loughran claimed that Price Waterhouse was thorough in its examination of the Bank's IT needs.

MR. LOUGHRAN - I note that Price Waterhouse reviewed a total of 21 banking system. Thirteen of them are listed in this report that I have here. At the end of the report they recommended, after several weeks and months of discussions, that only two the Ultradata and FACTS system and the FNS BANCS system, which the bank eventually chose, were likely to deliver an acceptable outcome.

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39 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 28
40 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 27
Mr. Loughran further advised that

*From then on the Price Waterhouse work was narrowed down to working towards which of the two would be superior.* 

Mr. Loughran quoted from the Price Waterhouse report which recommended that the FNS BANCS system was superior.

MR. LOUGHRAN – *We believe that FNS BANCS is the strategic long-term solution for the bank for the following reasons. FNS BANCS is gaining growing acceptance both in Australia and overseas as the preferred package solution for banks pursuing an open systems-based architecture. FNS BANCS has significant and growing install bases. It is currently being implemented in over 40 locations worldwide for the ANZ Banking Group. FNS BANCS provides a good fit to Trust Bank’s requirements. The overall fit percentage is around 77 per cent. That’s an important number, Mr Chairman, I’ll come back to because it’s the other 23 per cent that ended up costing us a lot of money.*

Mr. Loughran then went on to explain the quantum and the reasons for the significant price escalation.

*They recommended a cost of $15 million, which has previously been published, and within a month that was amended to $16 million and it ended up costing us, as has been previously published, I think it’s been published at $23 million, it was $22 million. Most of the additional cost over a two-year period was due to the customisation - in other words, changing the software to meet the bank’s unique requirements.*

When questioned about the commissioning process Mr. Loughran attested to the thoroughness of the process and confirmed that the systems were run in parallel for a period of time.

MR LOUGHRAN - *Yes, we ran the two systems parallel for quite a while.*

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41 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 30
42 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 30
43 Mr. Loughran Transcript of Evidence 19 May 2000 Page 30
44 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 35
On the matter of hardware Mr. Loughran stated—

'I'll move now to the hardware. A review of a number of major outsourcing vendors, including ISSC, Telstra and Hewlett Packard was conducted, with Hewlett Packard selected as the preferred supplier of outsourcing services. I'm pleased to say that with Hewlett Packard, they were a company that delivered on time and to budget all the time. 45

The PAC notes that Minter Ellison negotiated the hardware contractual arrangements between the Trust Bank and Hewlett Packard.

Mr. Loughran further advised that Hewlett Packard selected Computerland to install and maintain their product according to the manufacturer's specifications.

Mr. Loughran tabled for the consideration of the PAC the following documents related to the acquisition and commissioning of the IT package.

- Precis of Key Findings and Recommendations dated November 1995 detailing a vision for the Bank's future and the role of IT in that future.
- Detail concerning the Banking System Migration Project.

The reports were comprehensive and considered to be expert in their presentation.

10.2 FINDINGS: TECHNOLOGY PLATFORM

- For a period prior to 1994 the Trust Bank's commitment to IT was under funded.
- The need for IT upgrade was known to management and the Board of Trust Bank in early 1994 and action was initiated with a view to meeting the need.
- The process leading to the commissioning of Price Waterhouse as the preferred consultant was valid and involved the consideration of at least three alternate consultants.
- Price Waterhouse thoroughly considered the range of options and recommended accordingly.
- The Board of Trust Bank was advised by Price Waterhouse that the recommended software was 77% compatible with the Trust Bank need.
- Price Waterhouse estimated that 500 additional man hours were required to customise the software to the Trust Bank need.

45 Mr. Loughran, Transcript of Evidence 19 May 2000 Page 37
11.2 FINDINGS: FINANCIAL INFORMATION AVAILABLE TO DIRECTORS

- Appropriate data and reports were available to the Board during the critical period from December 1998 to April 1999.
- The combination of a new technology platform and a significant change in bottom line trends caused uncertainty and alarm in the minds of the Board members during this time.

12. COSTS OF SALE

12.1 OVERVIEW

The PAC was aware that $12 million dollars was deposited in the Special Deposits and Trust Fund to be held against any liabilities or outstandings and ongoing obligations of TB No1 Limited.

During evidence Mr. Loughran itemised the sale costs as follows:-

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salomon Smith Barney Fees</td>
<td>$2.230 million</td>
</tr>
<tr>
<td>Directors Retirement Allowance</td>
<td>$0.520 million</td>
</tr>
<tr>
<td>R &amp; D Syndicate costs</td>
<td>$0.500 million</td>
</tr>
<tr>
<td>Outstanding Trust Bank liabilities, tax etc</td>
<td>$0.200 million</td>
</tr>
<tr>
<td>Contingency</td>
<td>$1.350 million</td>
</tr>
<tr>
<td>Crown costs</td>
<td>$0.200 million</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$5 million</td>
</tr>
</tbody>
</table>

The Hon Dr David Crean, Treasurer has advised the PAC that the $5 million already drawn is considered sufficient to meet all the costs of winding up TB No.1 Limited and its subsidiary companies.

If this is so the Treasurer advised the PAC that the balance remaining in the Trust Account will be used to further reduce State Debt.

12.2 FINDINGS: COSTS OF SALE

- A sum of $12 million was established to meet the liabilities or outstandings and ongoing obligations of TB No1 Limited.
- It is very likely that TB No1 Limited will only require $5 million or thereabouts to meet its financial obligations.
- The balance of the amount in the Trust Account (about $7 million) will be used to further retire State Debt.
13. SENATOR MURPHY

The PAC received correspondence from Senator Shayne Murphy on 22 May 2000, 5 June 2000 and 28 June 2000 advising the PAC of his interest in the inquiry.

The PAC noted that Senator Murphy referred several allegations to Tasmania Police for investigation.

In his letter of 5 June 2000 Senator Murphy advised that he wished to speak with the PAC on matters other than the matters referred to Tasmania Police.

The PAC wrote to Senator Murphy requesting him to particularise his allegations.

He failed to do so.

In his letter of 28 June 2000 Senator Murphy acknowledged the PAC’s request.

Whilst I acknowledge your invitation to detail my concerns to you, it is not a satisfactory approach from my point of view.\textsuperscript{46}

Senator Murphy did not make any further contact with the PAC.

The PAC notes that the Tasmania Police inquiry into matters raised by Senator Murphy has been concluded.

The PAC has perused the findings of Tasmania Police and is satisfied with their conclusion that on the totality of the evidence there is no criminal conduct disclosed in Senator Murphy’s allegations.

14. MR. A JOHNSON

Mr Alwyn Johnson wrote to all members of Parliament and to the PAC on a number of occasions. Mr Johnson was a former employee of the Tasmania Bank whose employment was terminated in 1991. For reasons cited earlier in this report the PAC limited its investigations to specific issues related to the sale of Trust Bank to Colonial Bank. As Mr Johnson’s employment and experience related to a much earlier period the PAC did not consider nor make any judgments as to his claims. Since commencing this inquiry it should be noted that on 13 August 2000 the Federal Government has announced that it will conduct an inquiry into the sacking of Mr Johnson by the Tasmania Bank.

\textsuperscript{46} Senator Shayne Murphy, Letter dated 28 June 2000
• In fact the need was much greater and as a result of the customisation program the actual cost escalated by $7 million.

• During the commissioning process the ‘old’ and the ‘new’ systems were run in parallel for a period to confirm the accuracy of reporting.

• The supply and installation of the hardware component of the IT platform was delivered on time and within estimates.

11. FINANCIAL INFORMATION AVAILABLE TO DIRECTORS

11.1 OVERVIEW

Evidence given by Mr. Loughran at the first hearing on 31 March 2000 indicated to the PAC that for a period from December 1998 until April 1999 the Board of Trust Bank did not have important information available to it.

At the second hearing Mr. Loughran argued that such was never the case and the Board at all times had a flow of information sufficient to allow a proper consideration of the issues of the day.

In response to the PAC’s request for information to support that contention Mr. Loughran tabled a range of documents including:

(a) A series of Finance Board Reports detailing Profit & Loss performance.
(b) Sample copies of Management reports to the Board.
(c) Copies of Minutes of TB No1 Limited dating from May 2000.
(e) Finance Board report 31 January 1999 Draft other Income analysis.
(f) Finance Board report 31 January 1999 DRAFT EXPENSE ANALYSIS.
(g) Trust Bank BALANCE SHEET and BALANCE SHEET NOTES as at 31 January 1999.
(j) Asset/Liability Committee report for meeting 27 January 1999.

The sampling of reports allowed the PAC to determine that the Trust Bank Board had sufficient information to meet their obligations as prudent managers of the asset.