LEGISLATIVE COUNCIL

GOVERNMENT BUSINESSES SCRUTINY COMMITTEE A

Thursday 4 December 2008

MEMBERS

Ms Forrest
Mr Hall (Chair)
Mr Harriss
Mr Martin
Mr Wilkinson

IN ATTENDANCE

Hon. Michael Aird, Treasurer

Ministerial Office

Mr David Bailey, Head of Office
Mr Anton Voss, Senior Economic Adviser

Tasmanian Public Finance Corporation

Mr Don Challen, Secretary, Department of Treasury and Chairman of the Board
Mr John Hindmarsh, Chief Executive Officer
Mr Bruce Rose, Senior Manager, Administration

The committee met at 9 a.m.

CHAIR (Mr Hall) - Good morning, everybody. We may as well get straight into it. Treasurer, would you like to give a brief overview of the last 12 months?

Mr AIRD - In this particular area I suppose what is going on in the global financial crisis is pertinent. I think you would know from the Auditor-General's Report that his observation was that Tascorp had positioned itself well in terms of the subprime market in the US. In subsequent times Tascorp has had, I think, a conservative approach but it has proven to be a really prudent approach. I think the board under Don's leadership and John and the management team have done a terrific job. Obviously there are going to be issues to face in the future but I think Tascorp, in a very difficult time, has positioned itself well.

CHAIR - I notice an operating loss of $1.9 million for 2007-08 but still paying a dividend of some $3.5 million and retained profits dropped from $12 million to $6.7 million. Do you think it is still prudent to pay such a large dividend when a loss has been recorded?

Mr AIRD - It has been factored in all the way through. It is not an unusual situation for organisations such as this to have a dividend policy like the one that we have in place. I have not had any complaints from Tascorp.

Mr WILKINSON - It is the first loss in four years, though, isn't it?

Mr AIRD - That is what I am saying - in terms of having a dividend policy such as that it is not a major issue, I think.

Mr WILKINSON - What will the dividend this year be?

Mr CHALLEN - The combined dividend and tax equivalents will be $3.5 million.

Mr WILKINSON - And what was last year's?

Mr CHALLEN - It was $3.5 million.

Mr WILKINSON - So it is the same dividend.

Mr CHALLEN - The board has recommended a dividend policy that is based on the current and historical level of retained earnings of $3.5 million and we expect to be able to pay $3.5 million each year for the foreseeable future.

CHAIR - So that is the forecast for the next financial year as well.

Mr CHALLEN - Yes, that is the intention in the steady State, as it were. When this dividend policy was bought in it was as a response to the implementation of IFRS because mark-to-market gains and losses were going to import more volatility into our reported results. As you can see from note 3 in the financial statements, we made last year $11.8 millions' worth of margin income. Pretty much that is in cash and the reason that we made an operating loss was that we had mark-to-market valuation movements that were taken into account in the P&L that offset more than the amount of that margin income. Nevertheless there was $11.8 millions' worth of cash being generated from the business and, as we explained in that briefing that we gave to the members of the Legislative Council a couple of months ago, those mark-to-market losses will wash themselves out as the assets and liabilities that are on our balance sheet lose maturity. There is no reason we cannot pay the $3.5 million even in a year in which we have made a loss on P&L.

Hypothetically - and I think it is just hypothetical, it is just a theoretical possibility - if we were to make a sequence of losses year after year then our retained earnings would be eroded and the board would have to have another look at our capacity to keep paying that $3.5 million. On what we now know, that is purely hypothetical and we expect to be able to continue to pay.

Mr AIRD - That is exactly right. If it was shown to me that the retained earnings could not sustain it, then obviously we would review that, but that is the basis of it.

CHAIR - Just following on from that, in this coming year what are the forecasts? Could there be further losses given the volatility of the markets?

Mr CHALLEN - Our corporate plan is to make a profit this year. It is very early days and I do not want to speculate on the outcomes. These are extremely difficult market conditions we are in but, shall we say, we are comfortable with where we are positioned a bit over one-quarter into the year. We are running more or less on budget.

Mr WILKINSON - Are you the same as where you were approximately, Don, at the end of June, a $3 million loss at the end of June?

Mr CHALLEN - No, for the part of the 2008-09 year that is already under our belt we are performing better than that.

Mr WILKINSON - It is better than that.

Mr CHALLEN - Yes. If you go back to the presentation materials that we gave you at our briefing a couple of months ago you will see we showed you a three-year picture of our corporate plan expectations. We are pretty much on track for those numbers.

CHAIR - Have you made any changes to your investment portfolios?

Mr HINDMARSH - We are always dealing with maturing investments and the reinvestment of funds so that there are changes on a daily/weekly/monthly basis as a consequence. Yes, the portfolio has changed since the start of the year, but I do not think it has changed in a structural sense. We are still investing short term. We are still investing predominantly with banks and I cannot see that that situation will change for the foreseeable future.

Mr WILKINSON - Have there been any significant changes to the investment portfolio since the difficulties in the market have occurred?

Mr HINDMARSH - No, we continue to invest money, as I said, in banks. That has really been our focus over the last six to nine months. We took a view that the credit markets were going to face a difficult period through 2008 and probably into 2009 and we felt that the better risk position for Tascorp was to invest in the banking industry and therefore get exposure to as wide a group of counterparties, if you like, through the banks than to try to pick counterparty *x* versus counterparty *y* versus counterparty *z* ourselves. I think that has proven to be the right strategy, and certainly in the period post-12 October when the Prime Minister announced that the Commonwealth would guarantee banks. We have been very pleased with our decision to go into the banks when we did.

Mr MARTIN - When did you change to that strategy?

Mr HINDMARSH - Progressively through this calendar year. Really, I suppose, when we looked at the financial markets in the period beyond when the subprime crisis started. The subprime crisis started in August 2007, properly, and by the time we got to February/March 2008 we knew that the markets were in serious disarray. March, of course, was when the Bear Stearns problem happened in the United States and they were effectively forced out of business. It was about that time that we decided it was not a particularly good market to be picking corporates that were going to do extremely well or not do well, as the case may be. It is better to spread the risk as far and wide as you can and go into organisations that are going to definitely be here tomorrow and the day after, and the day after that.

We considered the banks in Australia, particularly the major banks in Australia, represented the best investment opportunity from a risk standpoint at that time.

Mr MARTIN - How long do you think you'll stay with the strategy?

Mr HINDMARSH - I do not know. We really do not know.

Mr CHALLEN - It could be a long time. The point is that the Commonwealth Government's intervention to provide guarantees on deposits with banks and approved deposit institutions and, most particularly, their guarantee on bank wholesale funding has severely distorted the market. I think the likelihood is that we will stick with our current, very conservative policy until the market re-normalises. How long is that going to be? No-one can tell you.

Mr MARTIN - It would be a good Don Challen projection though.

Mr CHALLEN - I think we may be in for an extended period of years before the Commonwealth can withdraw those interventions and, until it does, the market won't be normal. There may be some alternative way through it, but that, again, would require some action on the part of the Commonwealth.

Mr MARTIN - I suppose the question we have to ask is if the situation gets worse from what it is today, is Tascorp safe and will the current strategy maintain you through the worst possible scenario?

Mr CHALLEN - That is a big question. Tascorp's current strategy is very conservative and it is designed to be reasonably robust for even worse market conditions but you can contemplate conditions in the market in which our business model is called into question.

The history of the development of the so-called crisis is quite interesting because in the early months, particularly after the Bear Stearns collapse, John mentioned things were moving in Tascorp's favour, so there was a flight to quality occurring and the margins at which we could issue our paper were more and more favourable to us. At the same time, there were other assets in the marketplace that we would normally invest in and widening credit margins as the whole market shifted into, basically government paper.

On both sides of that spread, we were getting a favourable movement and, indeed, that was the big reason for those mark-to-market losses that we experienced last year, as we explained in that briefing, because it got to a point where confidence in the market started to break down and this occurred in late August and September of this year. Then governments around the world began to intervene. In particular, the intervention in early October of the Commonwealth Government in the Australian market basically killed off the bond market for the State and

Territory issuers because by guaranteeing the wholesale funding issues of the banking system, they made bank paper more favourable than our paper.

In the last six weeks or so we have seen a shift in preference of investors away from our paper into Commonwealth Government-guaranteed major bank paper, basically. If you look at what has been happening in the market in the three or four business days now since the wholesale funding guarantee became effective last Friday, there has been a massive amount, and I mean a truly massive amount, of access to that Commonwealth Government guarantee as of close of business on Tuesday. In just three business days there were $12 billion worth of guaranteed issues by banks.

[9.15 a.m.]

Tascorp's normal funding vehicle is its preferred stock, its bond issues, and we are not issuing - we cannot issue. We are now currently dependent on our shorter-term issuance, commercial paper and the domestic and the Euro-CP market.

Mr MARTIN - Should the Federal Government be doing something to change that?

Mr CHALLEN - We are asking them to. We are saying to them that this situation is not sustainable in the long term, the Treasurer has written to the Commonwealth Treasurer about it, the Queensland Treasurer has written on behalf of all the States, the issue has been raised with heads of Treasury meetings twice, I have written to Ken Henry, my colleagues and I have had many discussions with Commonwealth Treasury people, the issue was on the Loan Council agenda last Friday -

Mr AIRD - We raised it with the Commonwealth Treasurer last week.

Mr CHALLEN - and what we have got back from the Commonwealth Treasurer is that they understand the problem, and they are sympathetic; they will work with us to find a solution. But so far, the solutions that we have proposed have not been accepted. We do not have an immediate problem because we can fund ourselves with CP but Tascorp's business model is based around being able to issue bonds for their stock. If we find ourselves in a situation where for years and years we cannot issue bonds, we will have to find some other business, I think.

On the asset side of the balance sheet, as John said, we are very comfortable. We were investing in mainly major Australian bank paper guaranteed by the Commonwealth Government, so it looks as good to us as it looks to everyone else in the market.

CHAIR - Is the $3.5 million dividend paid in December? Do you give the Treasurer a Christmas present then; is that the way that it usually happens?

Mr CHALLEN - On 15 December.

CHAIR - Okay, he is looking at his watch expectantly.

Mr AIRD - In 12 days.

Mr WILKINSON - Does it concern you that we have gone from $45 million to $22 million to $16 million? I know that it is a volatile market and everybody knows what has occurred with it, but it is certainly a significant drop from where it was a while ago, isn't it?

Mr CHALLEN - What is the $45 million, the $22 million and the $16 million?

Mr HINDMARSH - The $45 million was the effective capital limit that we had with the Treasurer before we reduced it to $22 million.

Mr CHALLEN - What is the $16 million?

Mr HINDMARSH - The $16 million is the amount that is left on the balance sheet after we paid the dividend.

Mr CHALLEN - They are not quite the same number.

Mr WILKINSON - Having looked at the numbers I thought that there had been a marked reduction.

Mr HINDMARSH - If you wanted direct comparisons you would have to go $45 million to $22 million and then back to $27 million, which is what the Treasurer gave us when we approached him in April, I think it was this year, when we asked him for $5 million worth of additional capital to deal with the volatility in the financial market. The direct comparative is $45 million to $22 million back up to $27 million.

Our capital base is a combination of what we have on the balance sheet and what the Treasurer has agreed to guarantee.

Mr CHALLEN - The $45 million to the $22 million was a result of the board's decision that we wanted to make our balance sheet more conservative so that we were less exposed to volatility in the markets and we then said to the Treasurer that we did not need $45 million of effective capital, we could run this business with $22 million.

That was all pre-global financial crisis. Through last financial year, as markets went mad and volatility started to rack up, we went back to the Treasurer and said we could not maintain the balance sheet, that we had at $22 million effective capital, we did not think that it was smart to further shrink the balance sheet so that we could operate with $22 million so could he expand our effective capital by $5 million to $27 million to allow us to continue to maintain the balance sheet that we already had and we would see whether the markets settled down.

That is the point that we are at now and the markets have not settled down. The Tascorp board is getting together for a special meeting at the end of January, early February, when we are going to have another look at the way that we run the business, what the balance sheet needs to look like and how much effective capital we need to run it. Without prejudging the outcome of that important board discussion, my guess is that we will be going back to the Treasurer saying we need more capital because of increased volatility.

CHAIR - Don, you talk about the board meeting again and looking at that. I noticed on page 4 of the annual report that there is a review of the corporation's liquidity policy to be undertaken.

Mr CHALLEN - I am talking about capital policies and there has been a separate review of the liquidity policy, which John would like to talk about. But the particular issue we are meeting specially for early next year is to look at how we run the business in these very difficult market conditions and how much capital we need to effectively run the business. That will require a further conversation with the Treasurer about our access to effective capital.

Mr AIRD - I think that, if you were going to summarise the state of play, we are alert to the uncertain conditions. Tascorp positions itself really well in the conservative framework that they have put in place and that -

Mr WILKINSON - It has always been conservative.

Mr AIRD - But a more conservative, if you like, prudent policy. Now the board needs to consider all the implications for their business. Included in that is the possible response of the Commonwealth. But they might have made a decision by then.

Mr CHALLEN - It is likely they will not.

Mr AIRD - Might have.

Mr MARTIN - What happens if they have not?

Mr AIRD - We do not have an immediate problem but they cannot continue to overly delay their response to our requests. Having said that, I will take advice from the board. But, in general, the board and the management team have positioned Tascorp as well as anyone could possibly expect to do in terms of the uncertainty of the times.

CHAIR - No doubt you will look at the worst-case scenarios and that is what the board will do. Is there an existing assessment of the absolute worst-case scenario?

Mr CHALLEN - Our views of that, Chairman, change as the markets evolve. Part of our normal daily management of balance sheets is to do stress tests of what would happen if worst-case events occur. Our view of what was a worst-case event a year ago was based on experiences during the late 1990s with the Russian crisis and the collapse of long-term capital management and so on. But in the 12 months just behind us we have seen market conditions that no-one has ever seen before. So our view of what is the worst-case scenario is a lot worse than it was before.

Mr MARTIN - I remember my 1980 macro-economics lecturer telling me about this crisis.

Laughter.

Mr CHALLEN - You have perfect foresight.

Mr AIRD - Did you sit the exam?

Mr MARTIN - I did.

Mr AIRD - How did you go?

Mr MARTIN - Distinction.

Mr AIRD - Did you?

Mr MARTIN - I did.

Mr AIRD - I should not sound so surprised.

Mr MARTIN - I had a very good lecturer.

Mr CHALLEN - You can only work with the material.

Clearly, in the work that John's team will do in the lead-up to that board meeting I spoke of, there will be some very serious consideration of what is a worst-case shock that we might experience and how we would manage our way through. So we will do all sorts of horrible scenarios when we think about how we would manage the business in this particular state of affairs.

I think it is important to emphasise the point the Treasurer made, though, that we do have a business-as-usual model for the moment and it is okay for market conditions that are foreseeable at the moment. But, as I said earlier, we are in uncharted waters and it is extremely difficult to predict the outcomes.

Mr MARTIN - Seriously, the worst-case scenario has probably changed almost weekly in the last couple of months, hasn't it?

Mr AIRD - It has changed in the last four days.

Mr CHALLEN - There are things happening in response to the Government's wholesale funding guarantee that we had not anticipated.

Mr MARTIN - That is the problem when you do an unexpected intervention in the marketplace.

Mr CHALLEN - It is extraordinary. People will be writing about these events for 50 years.

CHAIR - I note on page 9 of the annual report that there is a loss of $160 million of client deposits. What was the reason for that?

Mr HINDMARSH - That was the decision we took a little over 18 months ago to remove one of our investment products that we had been offering. We offered a product that was a bond index product, where our clients could invest in a market index of a range of bonds and get a guaranteed return from that. We then had to go out on the other side and buy the individual bonds and hedge up the residual risk to make sure that we were not exposed to adverse movements in the marketplace. What we found in 2003-04, when we were looking at our capital policy, was that we were allocating a huge amount of capital to the hedging up of that risk and to the ownership of those bonds that we had to put on the other side of the contract we had with the depositing clients. We could not make it pay, so we got to the point where we said, 'If we can't make it pay, are we going to continue to offer this product or could our clients go and get the same product, or perhaps a better product, elsewhere in the private sector?' The board considered a strategy payment that the management team put up and decided to withdraw from that particular product and take it out of the market. There were four affected clients and we spoke to them.

They found other places for their money. They withdrew their $160 million and put it in other places.

CHAIR - If I move another page down the annual report, you were expecting a 13.3 per cent return on effective capital to turn it around somewhat. What was the magnitude of the negative return?

Mr ROSE - The weight of average effective capital employed in the year to 30 June 2008 was $22.6 million. That is a combination of the $22 million and the $27 million that we spoke about before. The profit after tax was a loss of $1.89 million, so the return on the effective capital employed was -8.4 per cent. In the previous year it was +17.5 per cent.

CHAIR - It is a huge turnaround, is it not, but that is the way the world is, unfortunately.

Mr WILKINSON - The report seems to lack some detail in relation to which securities suffered the revaluation losses. In relation to those, and I do not particularly want to know exactly which ones they are, are you still in them or have you got out of them?

Mr HINDMARSH - No, we are still in them because you cannot get out of them. The reality of the subprime crisis and how it has evolved over the last 12 to 15 months is that the bond markets, the investment markets, have frozen. If you went into the crisis with an investment portfolio that you did not subsequently like or want, there is not much you can do about it. That is one of the learnings that everybody has taken out of this experience. We are not concerned about the investments we have in our portfolio that might have been marked down because the markdown was, in the context of our total investment portfolio, less than 1 cent in the dollar. It is not as though we are marking down 10 cents, 20 cents or 30 cents in the dollar. We are quite comfortable with the underlying credit exposure of the investments. We expect to continue to receive the interest flows from those investments and continue to expect to get the money back when those investments mature. We think that the markdown in the 2007-08 year, and the 2008-09 and 2009-10 years, will be recovered as those investments mature.

[9.30 a.m.]
Mr WILKINSON - It is interesting looking at questions and answers in relation to the GBE when the House of Assembly had it in 2007. I noted Don saying it is a tidy little business. It was then.

Mr CHALLEN - It still is.

Mr WILKINSON - That is what I was going to say.

Mr AIRD - It is a neat business.

Mr WILKINSON - Even in relation to the problems which we are seeing - and I know we are seeing them worldwide and Australia is probably better couched than the rest of the world in relation to them - are you still quite happy that 'it is a tidy little business'?

Mr CHALLEN - Yes, in fact our strategy is to hold those assets to maturity. These losses are the result of valuation changes, mark-to-market valuation changes. Provided none of the assets that we are invested in defaults - and as John says, our credit analysis suggest that is extremely remote - just by holding these things to maturity we will get the cash revenue streams we expect to get and the mark-to-market losses will wash themselves out as we go to maturity. If you think back to that briefing we had a couple of months ago, you will remember we showed you a little illustration of how that occurs. Our strategy is that we have good-quality assets, we are going to stick with them to maturity and take the cash earnings that we have always expected.

Mr WILKINSON - If you were a gambler one could argue that, because you have the long-term assets if the situation comes where it might be obvious to the experts that there are other assets that should be invested in, do you still have that flexibility to be able to get into those assets?

Mr CHALLEN - Yes, but if we sell these assets then we turn those unrealised mark-to-market losses into realised losses. We crystallise them and we do not wish to do that. The other thing is that our strategy is to hold shorter-dated assets. We do not have many assets in our portfolio at all that are long term because they are very difficult to manage in terms of their call on effective capital. We do not have to wait a long time for those mark-to-market losses to reverse. We are only talking about two years, two-and-a-half years at most.

Mr HINDMARSH - Quite a large percentage of our portfolio is invested for terms of less than 12 months. If we had an investment opportunity that suddenly emerged which, as you have described, Mr Wilkinson, was a good opportunity and one we wanted to capture, then we could convert some of our short-term investments into those other opportunities simply by maturing the short-term investments. We do not have to sell anything to be able to do that.

Mr WILKINSON - Am I right in saying, if you lift your capital by going to the Treasurer and, as you said, it went from $22 million to $27 million, it was $45 million, if that was increased that would give you the ability to do that as well?

Mr HINDMARSH - It would, but I do not know if that would be a driver.

CHAIR - What about growth prospects for the coming year? Local government are obviously one of your major clients. Are there any good prospects or do you see them also being fairly coy about what they want to borrow from you? They do it both ways; they also invest with you, of course.

Mr CHALLEN - We have two big opportunities at the moment on growing business. One is funding the new water and sewerage corporations which are obviously likely to have big capital programs over the next decade and we expect we will be lending to them. The other short-term one is Aurora Energy Tamar Valley, the vehicle that has the Tamar Valley power station, which of course is busily constructing a new power station at Bell Bay.

CHAIR - We will be looking at that this afternoon, Don.

Mr CHALLEN - They would be our two biggest opportunities.

Mr AIRD - We did provide some local government loans in anticipation of the water and sewerage reforms. I think it was about $40 million, around about that anyhow in anticipation of water and sewerage reform, so it has already gone to the councils but will be swept back into the corporation. That is already happening.

CHAIR - What about any borrowing for a new hospital?

Mr AIRD - I have not even got to that position.

CHAIR - Haven't you?

Mr WILKINSON - A slippery slope, it seems to me, with the oil underneath.

Mr AIRD - I admire your capacity to introduce a contemporary political issue. The fact is that we will not be making an immediate decision about any borrowing that may be required for the hospital. You might say from a policy setting, yes, you have the capacity to borrow.

Mr MARTIN - So you are contemplating borrowing?

Mr AIRD - I always have, and I am on the record of various hearings saying that. I am always surprised that people say it is someone else's policy, but I have always stated we have the capacity to borrow. What I have said is that we were not going to go back into debt, and that -

Mr MARTIN - That is still the situation?

Mr AIRD - Exactly. I do not anticipate going back into debt. I certainly do not want do that. That would be a policy setting that I think would be really retrograde, but that is not germane to this hearing. I will give you that little bit of information.

Mr WILKINSON - In relation to your staffing, what occurred with that during the year, if anything?

Mr HINDMARSH - It was very stable this last 12 months. We had a couple of people leave; one went to the mainland for an opportunity there, and we had one person who started with us on probation but was found not to fit the job, had difficulty with the job, so we did not extend their employment beyond the probation period. That, by comparison to a year earlier has settled right down -

Mr WILKINSON - The previous year was volatile, wasn't it?

Mr HINDMARSH - It was. In last year's GBE hearings we commented on that, and really there is nothing more to add to what we said last year. It is fair to say that the organisation has put that behind it and moved on, and we now have a very stable team.

Mr WILKINSON - Has anything changed in management that caused that to calm down, or is it a case where, as in a number of businesses from time to time, there is this volatility?

Mr HINDMARSH - No, we have not done anything differently inside Tascorp; we continue to do the things we have always done and the staff are remunerated exactly the same way with the same performance management system that we had in place in 2003. I think that we have just experienced some movement as a consequence of people deciding that they had better opportunities elsewhere, and of course in 2006 and 2007 the job market looked very buoyant. In 2007-08 and maybe 2008-09 it is not going to look like that.

Mr AIRD - It could have been a response to market conditions.

Mr WILKINSON - That is what I was getting at. It would seem to me that that might have been one of the main underlying reasons that occurred, because of the ability to get your experience in a certain area and then move on to maybe -

Mr HINDMARSH - It may have been, but I think the observation that is important to this discussion is that the team that we have now is very good. I do not think I could get better people to fill the positions. The corporation is well served by the current team.

Mr MARTIN - Given the changed circumstances, though, and the need to be more conscious of decision making, do you have enough staff with the skills needed?

Mr HINDMARSH - Yes, I think so. We have spent most of the last six or seven years that I have been at Tascorp trying to test where the optimum level for staffing is. On occasion we have had our numbers down to maybe 11 or 12 people, and on other occasions we have had 15 or 16. We have settled at about 14 or 15 and that seems to be where we have to be. Our business requires disciplines and segregation around certain duties so that from a risk management standpoint we know that the business is functioning properly. Our dealers, for example, have to be quite separate from the people who settle our financial transactions; we have to be quite separate from the people who assist the risk in the business and report to the board about the risk in the business.

Mr MARTIN - In the area of dealers, I was wondering whether, given the crisis situation, you would almost have to monitor on a daily basis, so do you not need more staff?

Mr HINDMARSH - No, because the global financial crisis actually puts more pressure on the risk team than it does on the dealers. The day-to-day dealing is the day-to-day dealing, that happens as a matter of course. Really the pressure is on the risk team.

Mr MARTIN - So you do need more staff.

Mr HINDMARSH - We do not need more people, we just need skilled people in that area. We are very fortunate to have a senior manager of risk in our business who I would regard as one of the best in the business anywhere in Australia.

Mr WILKINSON - Who is that?

Mr HINDMARSH - Peter Blyth.

Mr CHALLEN - In difficult times like these you need experienced hands. That is what you need and that is what we have.

CHAIR - Not old hands but experienced hands.

Mr CHALLEN - Experienced hands, they do not have to be old.

Mr AIRD - Sometimes they are both.

Mr CHALLEN - It is very difficult to be very young and experienced.

Mr WILKINSON - Yes. You need a mix, don't you?

Mr CHALLEN - You do.

Mr WILKINSON - How many people have you employed there?

Mr HINDMARSH - Right now we have 13 and two vacancies. We have a junior dealing vacancy which we are working on filling as we speak, in fact I have candidates for job interviews this afternoon, and we have a vacancy in our administration area, a support staff person.

Mr WILKINSON - In relation to this experience and competence, can you give us a background of the people you have and their experience and why you say and believe they are the best in the business?

Mr HINDMARSH - Let us start with Peter Blyth, as we spoke about him a moment or so ago. He has been in the banking business for maybe 25 or 30 years. He has spent most of his time in risk management and a lot of his career with the Commonwealth Bank. He has learnt the business over that period of time with a major financial institution in this country and one that is pretty good at doing what it does and he has transported all that knowledge and learning to our business. I have worked in a number of financial services organisations over my career with a number of risk managers as a consequence and I would regard him as one of the best that I have ever worked with.

Our head of financial markets is a lady with dealing experience that goes back to the 1980s. She worked for a time with the Hongkong Shanghai Banking Corporation group in both Auckland and in Sydney, so she brings what I would consider necessary experience to our dealing operation, the sort of leadership that we need in that operation, and we are lucky to have her.

Within the administration group, Bruce Rose has been with us for 13 years and in accounting all his career. He leads the team of accountants and that recently has had some people move in and out. We promoted somebody from within his team to the risk management team so Bruce has had to hire some new people. We have accountants in our organisation who have, over the last three years, really got down and learnt about mark to market and the consequences of mark to market in an accounting sense. As an organisation I think we are probably pretty much there in terms of that journey.

In operations side, our senior manager operations is similarly a banker. He comes out of the Bank of New Zealand and from what is called the back office in banks. His experience in that environment is in the order of 20-odd years and he runs our systems and our settlements team.

If those key players within our team were to leave tomorrow, do I think I could hire anybody better in the marketplace? The answer is no.

Mr WILKINSON - This is on *Hansard* remember and they could come back to you tomorrow for a pay rise.

Mr HINDMARSH - I am quite happy with this.

Mr WILKINSON - I do not want to reduce the capital any further.

Mr MARTIN - This is called 'all care no responsibility'.

Mr HINDMARSH - Quite frankly, I would not want to try to replace that experience as I think it would be hard.

Mr CHALLEN - Just to round that off, the CEO is sitting in front of you and you can see yourself he is highly professional, a very competent, experienced individual who has also spent his life in the financial system and the capital markets. The rest of my board are very experienced people who have also all spent their lives in various areas of banking and finance. The whole team mix together extremely well and are a very solid group of people.

[9.45 a.m.]
Mr AIRD - And to round it off, I think it is important to say that the level of governance to Tascorp is really important and that the skill sets on the board are reassuring given what we are facing in the future. The total picture in terms of the board, the management team and the practices that have been engaged in have been highly professional. If you look at the Auditor-General's report it is very reassuring.

Mr WILKINSON - I think it is important that we did look at it because it is a volatile period and that is why I thought it was necessary to ask it.

Mr AIRD - It was a good question because it satisfies, I think, in terms of reassurance to know that you have competent people running the organisation. I am more than happy.

Mr WILKINSON - In relation to the board, has that been stable over the last number of years or has there been some volatility in it?

Mr CHALLEN - The board has been very stable. Our last new member was Carol Austin who has just been renewed for her second term so she joined us three years ago. We have had one other change in the last couple of months as Sarah Merridew, who had been on the board for about a decade, retired and she has been replaced by Jann Skinner, who is a Sydney-based accountant who has worked in the major banks. Sarah's skill set in the range of skills that we need around the board table was as an accountant. She is Launceston-based at the moment. In terms of refreshing the board because she had been on it for a long time, it was time for her to retire and her replacement is also a very good-quality board member.

Beyond that, Bev Walters came from ANZ and subsequently the Primary Industry Bank of Australia. He ultimately became the CEO of Rabobank of Australia and has been on the board for probably six or seven years. He is an excellent contributor who knows the lending side of the business and credit analysis. Carol Austin, whom I mentioned earlier, has a career that goes from the Reserve Bank of Australia to the funds management business. These days she is one of the principals with a firm called Contango Asset Management, which is what they call a boutique funds manager. Carol is an economist by training so she has a skill set that is complementary to my own, but she brings particular knowledge and expertise on the funds management side of the business. John and I are the other two board members.

Mr WILKINSON - Don - you have been asked the question before in relation to different hats that you have worn from time to time - do you believe that you have a conflict at all in relation to being Chairman of Tascorp and also in charge of Treasury and therefore some might argue that if you are asking for more capital in relation to Tascorp, it might be taking away from government coffers elsewhere or vice versa?

Mr CHALLEN - The short answer, Mr Wilkinson, is no. Indeed if you look at the arrangements around the country, I think with one exception, the heads of treasuries are the chairs of the central borrowing authorities. The reason for that is that the central borrowing authorities are really the arm of the Government, the arm of the Treasury in the markets.

While someone else, I think, could perfectly well chair Tascorp if they had the right skill set and knowledge, I would not want to see the head of your Treasury not being represented on the Tascorp Board because I think the link between Tascorp's business in the market and where the Treasury is at and the Government's strategy is very important. We often talked about this around the Tascorp board table and I know, because I have heard it may times, the view of the other board members is that they do not think that Tascorp would function well without the head of Treasury being on the board. It is also very important to understand that out there in the financial markets, Tascorp is Tasmania's face so it is very important that we have a communication channel from the Treasurer and the Government and the Treasury through Tascorp to make sure that we are correctly projecting Tasmania's face to the rest of the world.

Mr AIRD - I want to add to that. If I thought there was some conflict, I -

Mr WILKINSON - I am not saying there is.

Mr AIRD - No, but I am just saying that if there was, I would seek a resolution to it.

Mr MARTIN - As you did for some other board. I have a mental block as to which one it was but there was one.

Mr AIRD - No, Mr Challen made a decision of his own volition to retire from Hydro.

Mr MARTIN - That is what I mean.

Mr CHALLEN - That was personal. I was chairman of the Gaming Commission and the Government made the decision a number of years ago that they did not want a State servant to be chairing the Gaming Commission though I had chaired it for about a decade at the time. So I quietly resigned.

Laughter.

Mr CHALLEN - I do not blame anybody.

Mr AIRD - I think it is to the Government's advantage to have Mr Challen sitting and chairing Tascorp. What you need here is a range of different characteristics, and I think the two positions go well together. Mr Challen has a great skill set to lead an organisation and the Auditor-General is as effusive as an auditor-general can be in his praise for how the organisation has been run.

Mr WILKINSON - You are right with respect to what you have said, that it is the same in a number of other jurisdictions and States. How have we fared in comparison to other States, when we look at the books for the last financial year?

Mr CHALLEN - Quite well. The mark-to-market losses that some other jurisdictions have suffered are proportionately much larger.

CHAIR - I want to follow on from a question I asked before about the growth prospects for this coming year, Don. We talked about major clients being local government and water and sewerage. Given the anticipated and, what is happening now, the downward pressure on interest rates, might that give some of your clients some heart so that they might embark on some cap-ex projects that they might not have done previously? Has there been any indication that they might look for more borrowings?

Mr CHALLEN - I am not aware of any but the analytics of what you're saying are perfectly correct, that the cost of borrowing in the marketplace has dropped so you would expect that some investment projects at the margin that did not quite meet the hurdle rate will now meet the hurdle rate so, at the moment, we expect there to be more enthusiasm for investment projects provided that on the demand side they remain good business cases. I do not know whether John has heard anything.

Mr HINDMARSH - No.

Mr CHALLEN - I have not heard of any particular one. We will expect the usual conversations with businesses like Transend and Aurora who are providing the infrastructure for the Tasmanian economy. If the Tasmanian economy continues to perform as well as it has over the last three or four years, you would expect that Aurora will be out there providing more funds for customer connections because new businesses are connecting out there, and Transend will continue its capital program to strengthen the transition system. We would expect that the Tamar Valley Power station will continue to be a substantial borrower until that power station is completed and the expectation is that in a few years' time it will be sold again and the funds will be coming back in.

CHAIR - I will not mention the hospital again and the potential of it.

Mr CHALLEN - The Treasurer has, but with my chair-of-Tascorp hat on, my attitude to that project is totally different from my attitude with my secretary-of-Treasury hat, you would understand, Mr Chairman.

Mr MARTIN - What would be the difference?

Mr CHALLEN - Perhaps we will not go any further down this path.

Mr WILKINSON - Does the borrowing of the Tamar Valley power station concern you? I say that because there are some questions as to whether it can get into the grid.

Mr CHALLEN - With my chairman-of-Tascorp hat on, we are perfectly happy with the borrowings. It is an excellent project.

Mr WILKINSON - Significant borrowings.

Mr CHALLEN - They are significant borrowings, yes, but the vehicle that the power station is in, Aurora Energy at Tamar Valley, AETV, is well-capitalised, the Government has made a $100 million equity contribution to that vehicle. They will borrow a couple of hundred, I think from memory, so they will have a very solid conservative debt-equity ratio - a very nice balance sheet and a good revenue stream coming up. They are well contracted. My expectation is that if and when the Aurora board and the Government decide in a few years' time that the time has come to sell that business it will be very attractive to investors.

Mr WILKINSON - Why are Babcock & Brown getting out of it then?

Mr AIRD - Have you been observing Babcock & Brown's predicaments nearly everywhere?

Mr CHALLEN - To put it as politely as I possibly can, Babcock & Brown have been rapidly deleveraging their balance sheet and selling off any asset they could find.

Mr AIRD - To me, the deal was as a long-term investment. It is going to provide a terrific return to the State. It did a number of different things for us. The $100 million has been put to good use, the borrowings will be put to good use building up an asset, securing the energy profile of the State. It ticks every box. As far as the outcome of this is concerned, we will have another viable entity that we have committed to divest at the appropriate time.

Mr WILKINSON - The question is, who is out there to buy it?

Mr CHALLEN - They will be queuing up.

Mr WILKINSON - Do you believe they will be?

Mr CHALLEN - It is a very good asset. If we do not make a substantial profit on the sale of that asset, I will be absolutely astounded.

CHAIR - Aurora is a matter that we will talk about this afternoon, but I suppose one potential risk in the short term is the depreciation of the Australian dollar and therefore imports of steel and that sort of thing. Are some of the costs going up, or you do not expect that? Has that been factored in?

Mr CHALLEN - It is all fully hedged. There is no foreign currency risk with that power station whatsoever.

CHAIR - So you could not see a cost blow-out happening with Aurora?

Mr CHALLEN - You would need to ask the Aurora people.

CHAIR - We will.

Mr CHALLEN - From what I know of the transaction - and I was heavily involved in it, as you probably know - there is no risk from that quarter of a cost blow-out. That project has been magnificently managed. I have the utmost confidence in the team that is running the project.

Mr WILKINSON - The Auditor-General's report is a good report and it is obviously a business that continues to be a good business. It has suffered the slings and arrows of outrageous fortune, one could argue, as a result of the downturn in the markets, but it seems that it is going to continue to be an extremely good business.

Mr AIRD - We gave you an update three months ago and we would probably be in a position say in six months to try to bring people up to speed about what is going on. The advantage for me in offering that type of briefing to you is to reassure you that it has been a prudently managed business and is in safe hands.

CHAIR - Thank you, gentlemen. I think we recognise that it is a prudently managed business, even though you have some ongoing challenges.

The committee suspended at 9.59 a.m.