

**Tuesday 4 December 2018 - Legislative Council - Government Businesses Scrutiny
Committee A - Tasmanian Public Finance Corporation**

LEGISLATIVE COUNCIL

GOVERNMENT BUSINESSES SCRUTINY COMMITTEE A

Tuesday 4 December 2018

MEMBERS

Mr Finch
Ms Forrest (Chair)
Mr Gaffney
Ms Lovell (Deputy Chair)
Mr Valentine
Mr Willie

IN ATTENDANCE

Hon. Peter Gutwein MP, Treasurer

Ministerial Office

Mr Andrew Finch, Chief of Staff

Tasmanian Public Finance Corporation

Mr Tony Ferrall, Chair

Mr Stephen Rochester, Chief Executive Officer

Mr Heath Baker, Head of Financial Markets and Client Services

Mr Ignacio Welch, Chief Financial Officer

The committee resumed at 10.47 a.m.

CHAIR (Ms Forrest) - Welcome, minister and your team. If you would want to make an opening statement, we will then have questions.

Mr GUTWEIN - I am happy to take questions.

CHAIR - TASCORP is always a tidy business. It has had some different responsibilities this year dealing with the Mersey money and the TT-Line money, and other members may have questions.

When we passed the legislation regarding the Mersey Community Hospital Fund, it was designed to last 10 years to fund the operations of the Mersey Hospital and the money was provided in a lump sum. It has gone into TASCORP almost as soon as it was received. It appears that fund, in its dedicated account, has underperformed and has fallen well short of what was expected or needed.

How was the money invested? Why hasn't it achieved the returns expected and, I would argue, needed, and what does this mean for the future projections of how long it will last?

Mr GUTWEIN - I will start with the last part of the question first. The fund lasts into the tenth year. The projections initially used were provided in concert with the federal treasury, we utilised a 4 per cent low rate and 6 per cent high rate. I noted some comments today in the press regarding the performance over the last year. There was a forecast around \$24 million to \$25 million for the first year.

CHAIR - \$25.6 million was in the budget.

Mr GUTWEIN - It achieved around \$16 million. The first thing that needed to be done, bearing in mind the money was received at the end of last financial year ago and the corporation had it from the start of the financial year, was to develop the investment strategy, which the board did.

That took some time to ensure they had the right risk profile for the fund, but they have landed the investment now and it is achieving between 3 and 4 per cent. The fund is now achieving almost 3.2 per cent and on this basis, takes us in to the tenth year.

It is fair to say most members would recognise we are in an extraordinarily low interest rate environment, at the moment. It would be my expectation that over time, we will probably see increases in interest rates. My hope would be the fund lasting for a longer period, but at the moment, based on the risk profile to ensure the capital is absolutely secure, it will provide, based on the returns we are getting, a return at the end of the tenth year.

CHAIR - Do you have modelling that shows a return to the tenth year, even though there is an interest rate of 3.2 per cent still lower than your 4 per cent, which is the low-growth, low-risk proposal?

Mr GUTWEIN - Do we have modelling? I have advice, yes.

CHAIR - You have not provided the modelling to show that.

Mr ROCHESTER - We have not brought it with us.

Mr GUTWEIN - Anybody could run a 10-year period with 3.17 per cent and come to the same conclusions we have.

CHAIR - Okay. I have actually tried to do this and it does not appear to go that far. This is why I am interested in your modelling to show it does. A couple of questions around when it is paid. It can make a difference as to when the dividend is paid each year. For the Health department to run the Mersey, is it paid in monthly instalments at the beginning or the end of the financial year. When is it paid?

Mr FERRALL - At the end of the financial year.

CHAIR - That will help then.

Mr FERRALL - There are two parts to this. TASCORP does not pay it directly to the Department of Health and Human Services. The Health department receives the cash it needs through the year via the budget. TASCORP effectively pays the general government sector at the end of the year.

CHAIR - So you keep it for the whole year, which will have an impact. That is obviously part of the modelling that shows you are getting to 10 years.

Ms LOVELL - Treasurer, you have spoken about the modelling. Based on this rate we are seeing reflected in this year's statement, the actual operating profit being significantly lower than the target, if that rate were to continue, how long would the fund cover the operating costs of the hospital?

Mr GUTWEIN - It is important to understand the way TASCORP went about this. It was sensible - the board needed to develop an investment strategy, needed to ensure they placed the money appropriately, based on the return achieved this year in terms of the 3.17 per cent, and taking into account the timing of landing of the investments, the money will provide for a payment into the tenth year.

I would have much preferred if we could have landed the investments on 1 July last year. It was important to ensure the board took the time to come up with the appropriate strategy and consider the risk profile. They have now placed the money in such a way that it almost provides us with the same return as the cost of funds we would borrow in the market. It is a very good and safe return. Mr Ferrall might have some further points.

Ms LOVELL - I would be quite keen, if it is possible, to also see the modelling at some stage. Like Ruth, our modelling does not reflect the same outcome.

CHAIR - On that point, are you able to provide it to the committee by the end of the week?

Mr GUTWEIN - We can take in on notice.

CHAIR - We do need to report fairly promptly to the parliament.

Mr FERRALL - We need to look at the form and nature of what you mean by the modelling. If you look at the investments we have for the portfolio and as at 30 June, there was a range of investments, but my significant component was in residential mortgage-backed securities. That is \$473 million and those securities have various terms.

Providing you with the modelling is not simply a spreadsheet multiplying $3.17x$ by 3.17 and here is the answer. We have a range of maturities in our investments and a series of points at which we have to provide payments to the general government sector. Some of those securities mature at points close to the time we have to pay, but it is not identical. You have a range of components in the complexity of the modelling. It is not something we would produce, such as in a simplistic spreadsheet.

Ms LOVELL - Yes, I understand that. It seems a target has been set. Presumably that target was the money required to last 10 years and was not significantly higher. That target is not being met. We need to have confidence, should that trend continue, that the money will last the full 10 years and be able to cover the operating costs of the hospital.

Mr FERRALL - The original statements around the funding were that with a return, broadly in the 4 to 6 per cent range, it would last in the 10- to 12-year range. It wasn't as if statements were made publicly that we were at an interest rate of x and this is exactly how long it will last. There was a range. When TASCORP looked at the investment, in order to have an appropriate investment strategy with appropriate levels of risk, the reality was you could not obtain that higher end of return. As a board, we optimised with an appropriate risk framework. The board wasn't driven to get 10- or 11- or 12-years funding. We were more driven to ensure there was an appropriate level of risk and optimising or maximising the period of return, which is why we are saying we are comfortable it gets us into the tenth year. We can meet nine full-year payments. In the tenth year, we will make a partial payment of the full amount required, but we are not going to achieve the full amount in the tenth year on our current parameters.

CHAIR - It would be helpful to see the modelling that shows this. We don't need all the background information, but it is important to understand what assumptions are being made. It could be that you have only \$1 million left in the tenth year.

Mr FERRALL - To clarify for the committee, even in the tenth year, the board has made a risk-adjusted return. We have effectively said we could get more than what we believe we are currently getting, but we have made some adjustments to that tenth year to acknowledge that all portfolios have some risk. We have a risk adjustment in the tenth year. This reduces the return we are currently budgeting on, even though we are still saying it is in the tenth year. If that risk adjustment is not necessary as we go across the balance of the term, we are currently budgeting on will achieve a higher return.

Mr GUTWEIN - I understand the committee's interest, with the mortgage-backed securities we have and the timing as they roll out. Most reasonable people are expecting interest rates to rise over the next period. There is upside risk in the way the portfolio has been structured.

CHAIR - You have a mixture of terms, which you would have to have anyway because you have to pay out \$70 million-odd every year.

Mr GUTWEIN - You do. You could run half a portfolio for five years and keep the other in cash and draw down the cash. There are ways of managing a portfolio like this. The advice I have received is there is upside risk as we reach the tenth year. The economic climate we are in is quite positive. We may achieve the full payment in the tenth year with the potential for more, depending on what happens.

CHAIR - It is cumulative. If interest rates stay low, below 4 per cent or 6 per cent as per your overarching requirement return, it has potential to become a bigger challenge each year. You will need 7 or 8 per cent to achieve the same return and make it last the distance, won't you?

Mr FERRALL - Currently, our portfolio is structured to achieve a payment in the tenth year. I think the point the Treasurer is making is that there are some components of the portfolio that will be reinvested and that there are some components in cash. Depending on those rates or what those components are reinvested in, there is still some potential for upside in those areas.

CHAIR - Would this be above 6 per cent?

Mr FERRALL - Not above 6 per cent but above the current cash rate. I can put words into the Treasurer's mouth, but he is effectively saying we are in a low interest rate environment and we have been in that for some time. There is a reasonable probability at some point within the period the Mersey fund is operating that there will be some uplift in cash rates and other rates, which may lead to a higher return on the components we haven't locked in.

Mr GUTWEIN - The committee wouldn't be attempting to raise concern in the community; I know that is not your view and we all want to see a good outcome from this.

CHAIR - No, we simply want to see how long it is going to last.

Mr GUTWEIN - The tenth year or thereafter, referring to the Mersey, will simply be funded from the budget under the existing arrangements as part of state and federal health agreements. By the time we hit the tenth year, the budget is going to be somewhere between \$9 billion- and \$10 billion-worth of revenue. I expect the payment to Mersey to be around \$100 million to \$110 million. On the 55 to 45 per cent split that currently exists under the current health agreement, the state would be liable for \$60 million to 70 million. That will be a fraction of 1 per cent of the overall budget position. The budget can sustain that; it is something we can plan for and we have plenty of time to do so.

Ms LOVELL - Treasurer, the fund is intended to cover the operating costs of the hospital and, presumably, that includes wages. Can you confirm that?

Mr GUTWEIN - Yes, it pays for the operating expenses of the hospital.

Ms LOVELL - Was that based on an indexation rate of 3.5 per cent per year? Can we presume the current modelling is based on a 2 per cent wage policy? How long are you expecting that policy to be in place?

Mr GUTWEIN - The current wage policy?

Ms LOVELL - Yes, if this fund is intended to cover the cost of the hospital for 10 years based on that indexation rate per year, are you expecting that wage policy to be in place for the next 10 years?

Mr GUTWEIN - I would like to see that wage policy in place as long as it is sensible and affordable.

Ms LOVELL - You expect it to be in place for the next 10 years to keep up with this agreement.

Mr GUTWEIN - Again, you are attempting to put words in my mouth. Our wage policy is sensible, responsible and affordable. It will remain in place as long as it meets those parameters. We are currently going through wage negotiations and the Government believes the 2 per cent is reasonable and affordable.

Ms LOVELL - Let me frame that a different way, so I am not putting words into your mouth. Should those negotiations result in higher than 2 per cent sometime in the future? What will that mean for this modelling and the Mersey community fund?

Mr FERRALL - It will be irrelevant to the fund because the fund pays \$78.1 million indexed at 3.5 per cent across the forward Estimates. It will potentially have a budget impact. If there was a wage outcome above the current budgeted parameters or any other operating expenses, that would be met from the general budget. The Mersey fund directly pays an indexed return across the 10 years. That is legislated.

Ms LOVELL - That has been based on the current wage policy.

Mr GUTWEIN - No, it is based on the indexation applied by the Commonwealth to the Mersey agreement prior to taking on this current arrangement.

Mr FERRALL - It was at 3.5 per cent.

Mr GUTWEIN - One of the reasons we look to manage the budget with sensible surpluses is that we can meet any challenge that arises over time. That is sensible budget management.

Mr WILLIE - Minister, the secretary is saying that if there are increases above 3.5 per cent, that will be met by the Consolidated Fund, not the investment. Essentially, what we have here is a fund that will part-fund the Mersey Hospital over 10 years if there are other budget costs. Is that what you are saying?

Mr GUTWEIN - I do not have a crystal ball, but the cost of prosthetics could go up; the cost of other supplies and consumables could go up. We have a fund in place that will provide a 3.5 per cent indexed return, based on the initial payment of around \$78 million, for a period that takes us up into the tenth year. If there are increases in expenditure, obviously they would need to be met by the budget.

Mr WILLIE - It is a fund that is subsidised, in a way, by the Consolidated Fund because it is based on 3.5 per cent. If that rises, you are going to have to find the money elsewhere.

Mr GUTWEIN - No, it is a fund that is backed by the state Government and the Consolidated Fund. The future of the Mersey is guaranteed. We have a fund that has been established and an arrangement that is in place that will provide an ongoing guaranteed return. Under the legislation, we are expected to ensure that the index is at 3.5 per cent if other costs increase or, conversely, decrease. These are matters that will be managed by the budget, but there will always be, based on the investment strategy we have established, our indexed \$78 million at 3.5 per cent coming out of that fund, for as long as it lasts.

Mr WILLIE - We have established that there will need to be, potentially, top-up payments across the 10 years if costs rise above 3.5 per cent - you have said that yourself.

Mr GUTWEIN - What we have established is that it is sensible for the government to have a strong budget position and, as with any area of expenditure, that we are in a position where, if things change, we are able to meet those changes.

Mr WILLIE - There may be a need to provide top-up payments across the 10 years and your language has changed, too; you are saying it will get us into the tenth year. Effectively, as you said, the last payment will be \$100 million to \$110 million, so we are potentially \$110 million short in the tenth year and there may be a requirement to fund the Mersey from the Consolidated Fund.

Mr GUTWEIN - I am not saying that at all. The point I was making earlier is that we are in a low interest rate environment. I see more potential for upside over the period of the 10 years than I see downside. I fully expect this to be able to fund into the tenth year and hopefully beyond that period.

If costs increase for the operation of the Mersey, the Consolidated Fund would stand behind it.

CHAIR - On that point, Treasurer, I want to ask an encompassing question to perhaps pick up some of these issues: if wages policy were altered so that it became 2.5 or 3 per cent rather than the cap at 2 per cent, what impact would that have? Mr Ferrall said it will not have an impact on the fund itself, but you said it would have an impact on the overall state budget. Would that then be factored into the budget or would it be done by a request for additional funding to support that or a supplementary appropriation? How would we see that?

I think what people worry about is it being hidden and not able to clearly see how it is being funded.

Mr GUTWEIN - Mr Ferrall has explained that we fund the Mersey out of the Consolidated Fund and then there is a payment paid annually to the Government out of TASCORP. The point I would make, and it is one I have been making regularly on wages, is that a 1 per cent increase over and above the 2 per cent costs the Government \$28 million a year.

CHAIR - Yes, but not just the people at the Mersey. Let us focus on the Mersey.

Mr GUTWEIN - There would a relative impact in terms of additional costs that would need to be met by the health system for people employed at the Mersey if there were an increase above the 2 per cent.

CHAIR - How would that be shown?

Mr GUTWEIN - At this stage, I am hopeful we will land at a sensible and affordable 2 per cent. That is probably more reasonably a question of the Health minister at Estimates.

CHAIR - Possibly, and you may not be able to answer this, but do you know how much it actually cost to run the Mersey last year and how much it is expected to cost this year, and the operating costs of the Mersey?

Mr GUTWEIN - No, I do not have that but I can explain what was provided by TASCORP in the Budget for the costs of running the Mersey, but that is a level of detail I do not have with me at the moment.

Mr VALENTINE - Most of it has been answered, but are there strictures placed on the operation of the Mersey based on the performance of the investment fund? Probably the answer is no, from what I have just heard.

Mr GUTWEIN - None whatsoever, no.

Mr VALENTINE - Okay. I will have other questions.

CHAIR - On the Mersey?

Mr VALENTINE - No.

Mr WILLIE - Minister, do you think it is reasonable to forecast 3.5 per cent growth in health spending over 10 years? When you look across the country - and health inflation can be quite damaging to government budgets - do you think it is reasonable to peg it at 3.5 per cent over that long period?

Mr GUTWEIN - The 3.5 per cent was chosen as a result of the previous agreement that was in place. That is my understanding. That is why that 3.5 per cent figure has been set. In health spending, I think all of us are attempting to ensure we have as efficient a health system as we possibly can. The 3.5 per cent was set as a result of the historical agreement that was in place.

Mr WILLIE - You just anticipate it being around that figure for the whole 10 years?

Mr GUTWEIN - No. The arrangement we entered into with the Commonwealth on the Mersey money was that we would invest that money and that we would return those funds to the budget for the benefit of the Mersey at the same rate of indexation previously applied.

CHAIR - Still sticking with the Mersey money, you talked about a roughly 3.2 per cent return. I understand from the Auditor-General's report that there are discount securities, bank term deposits and bonds. Can you give us a bit more information about the investment mix of these funds?

Mr GUTWEIN - I will defer to one of the experts.

Mr ROCHESTER - At 30 June, there was \$15 million in cash and that cash will build up over the year so we have cash in our bank account for the date of payment. It will vary. There is \$473 million currently in mortgage-backed securities with various terms, from short to quite long, out towards the 10 years. There is \$177 million in corporate bonds and floating rate notes, which gives a total at 30 June of \$665 million. As to the credit quality of those, just over 68 per cent are invested in AAA-rated investments, it is basically rats and mice spread across the remaining -

CHAIR - That is a Treasury term, I assume.

Mr ROCHESTER - There is 1.5 to 8.5 per cent in the different credit ratings down to the bottom of investment grade, which is BBB.

CHAIR - I look forward to the Treasury using the term 'rats and mice' in budget Estimates next year, if you could make a note of that.

Mr GUTWEIN - Now I am aware of it, I probably will use it.

Mr ROCHESTER - It is a diversified money market and fixed-interest portfolio. Going back to the original discussion of the 4 to 6 per cent, those numbers were based on portfolios containing growth assets - shares and equities - that would have generated much higher rates of return. The cash and fixed interest investments here are ones that provide a very stable return, albeit one that has to be managed.

CHAIR - The lower risk return?

Mr ROCHESTER - Yes. There is a very low risk of changes in the value of those over their life, whereas in the example of equity there was, from memory, close to an 80 per cent chance of a 30 per cent loss over the period of this investment, which is why the board came to the decision not to include them in the portfolio.

CHAIR - The risk is an issue here in managing that risk. Normally TASCORP takes a moderate- to low-risk approach to the investment of money because it is essentially Tasmanian taxpayers' money. Is this why this model has been chosen for this money, or are there other underlying issues?

Mr FERRALL - It is, but significantly, in the work TASCORP did and presented the board, if you invested in growth assets, there was a reasonable or high probability you would have years of negative return. The reality is, even though it is a 10-year payment horizon, it is a relatively short time when you are talking about investments. The scenarios we looked at showed you could reasonably expect negative returns, particularly early on in the investment period, which would then lead to a situation where you would run out of money much earlier. It amortises off quickly because, you have a lump sum of money, the return will never meet all the costs and some of the capital has to be eroded over the period. The actual investment horizon is not 10 years; it is much shorter than that.

We took an approach we needed to optimise within appropriate risk tolerance and risk parameters because, as a board, we would not want to come the Treasurer and say, 'We were investing this for 10 years, but it is year five and we had a large hit'.

Mr GUTWEIN - In taking the 10-year horizon, we reach the tenth year and the expectation of the size of the state budget, the size the payment ends up when it transfers back, is to be fully funded by the state without the benefit of this arrangement. Under the current state-federal health agreements, it a fraction of 1 per cent of the overall budget. We have always contemplated this provides for a period and we would move to where it would be absorbed by the state budget at that time.

CHAIR - On page 50 of TASCORP's annual report, under note 22, Directors' and Executives' Remuneration, under short-term incentive payments, there are management bonuses of \$114 000 and as described here, in all cases, for outstanding corporation achievements. Is there

any loss of bonuses for not achieving the outcomes of the Mersey money expectation or where bonuses given on that, even though it was significantly underperformed against the expectation of the budgeted return?

Mr GUTWEIN - What was in the budget was on the basis of the discussions with the federal treasury and looking at what long-term returns could have reasonably been expected depending on the mix of the portfolio. It was the 4 per cent 6 per cent set into the budget. As has been explained, the board took the time when receiving the money to make sure they landed the right portfolio with risk profile. We were not in this portfolio from day one of the financial year.

CHAIR - I am not criticising the board's performance overall. It says it is for 'outstanding' corporation achievements. Whether it is a key performance indicator - KPI - or not, one would expect it to fall significantly short in what was budgeted; I remind you of the numbers, \$25.6 million to 416.8 million - I would not expect to get an incentive payment for that.

How were the incentive payments affected by this and were they?

Mr GUTWEIN - I will defer to the chair and the CEO. The incentive payment is paid for performance across a range of areas. This is but one.

CHAIR - I accept that. The question is; reductions for the underperformance in the Mersey money fund?

Mr FERRALL - The answer is not explicitly in terms of the metric relating to the budget. From the board's perspective, implementation of the Mersey Community Hospital Fund was a very complex investment strategy. It was not a simple strategy and our view was management performed very well through the period in relation to the investment strategy. There was not an explicit, 'we have reduced the performance bonus by x because the budget was \$25 million and the outcome was \$17 million'. It was across a whole range of measures. That also included more broadly the budget performance of TASCORP as an organisation again which was counteracting the comment there was very positive. It is not a simple metric in terms of saying, 'Tick this box and you get a performance bonus' or 'Do not tick it, you do not'. You do not rationally go have you have got 90 per cent of it, so we pare it back on that basis. You take into account the whole range of factors of performance.

Mr VALENTINE - On a different topic, I am interested in the TT-Line payment.

CHAIR - Before you go to TT-Line, does anyone else have any questions on Mersey money?

Mr FINCH - I was interested listening to the talk about capping salaries for staff: does that apply to executives of TASCORP?

Mr GUTWEIN - For most government businesses, they are contracted positions. Mr Ferrall can answer more in that regard, but for most of the government businesses we need to go to the market for the necessary skills, expertise and executives. I think all cases are on contracts across their businesses.

Mr FERRALL - With GBEs and SOC's, you have to be cognisant of the Government's wages policy and that is the position TASCORP adopts. In relation to the CEO, the remuneration is indexed annually and all the GBEs and SOC's have been capped at or limited to 2 per cent.

Mr FINCH - How does the 4.85 per cent from last year to this year for the base salary work out?

Mr FERRALL - Depending on what was included in last year's in terms of any performance component. It could also include other changes that might have occurred in relation to the salary mix. Each GBE is set in a different band. There is a banded salary range is indexed on an annual basis. The indexation for the last few years for GBE CEOs approved by the Treasurer and the Premier, who is generally employer, has been at 2 per cent.

Mr FINCH - Increases such as Mr Baker, 7.54 per cent; Mr Fitzgerald, 3.78 per cent; and Mr Welch, 8.6 per cent increase are probably skewed a little bit, because of other long-term benefits. What you are saying is in their original contract, there are allowances for those increases to take place?

Mr FERRALL - There is a set of limitations on senior remuneration that relates to the CEO's salary. I have to remember the two tests in the GBEs and that limits it. With TASCORP, senior officer remuneration goes through a market benchmarking arrangement, we discount what is a purely market rate and strike wage increases for senior officers and other officers in TASCORP on that basis.

Mr FINCH - Is the market comparison with other executives of GBEs in Tasmania or do you benchmark nationally?

Mr FERRALL - We use what is called FIR and effectively apply a Tasmanian discount against that. In reality, we are under-market for TASCORP operatives in a national market and even in a Tasmanian market. Although there is no identical entity to TASCORP, if you look at the kind of people we need to recruit in relation to financial markets, we are below market in salaries.

Mr VALENTINE - That is some cost for living in paradise.

Mr GUTWEIN - That is the price we all pay. The percentages you raised, the component of total remuneration, Mr Rochester had total remuneration of \$390 000 last year. That was the year before, and total remuneration of \$393 000 this year.

Mr FINCH - Why did we have the drop in super of \$33 000 last year to \$25 000 this year?

Mr FERRALL - Under his contract, he has a right and entitlement to change his mix in superannuation. He has a TEC, a total employment cost. There are differing tax treatments for superannuation benefits you receive that are greater than \$25 000. At an individual level, you are probably ambivalent between taking it as superannuation or taking it as ordinary remuneration because the same tax rate tends to be applied. In one case you have it locked in super and in one case you have it flexibly. I am assuming that was the reason for the change.

Mr ROCHESTER - It is illegal for me to take more than \$25 000 in super. I have no choice.

Mr FINCH - How did the \$33 000 occur last year?

Mr ROCHESTER - It wasn't illegal to have \$35 000.

CHAIR - The rules changed.

Mr FERRAL - It was \$35 000 in the previous year and that was reduced to \$25 000.

Mr FINCH - Could we come back next year to speak with TASCORP and see increases made through contractual arrangements, again?

Mr ROCHESTER - The contractual arrangement relates to my total employment costs.

Mr FINCH - I am not speaking specifically of you but more generally, such as these executives here.

Mr ROCHESTER - It is the same position. The totals on the right-hand side of those columns are subject to the 2 per cent government policy limits. That is taken into account. We also test against the market in the Australian context and the Tasmanian context. As the chairman has pointed out, the remuneration strategy that operates within those frameworks is conservative. For example, taking mine to illustrate, it goes from \$390 000 to \$393 000. We have been conservative within those frameworks.

The changes in the mix are driven by individual preference and the impact of changes in law. We have no control over the change in law and it is reflected, as you saw there, in the change in the superannuation. The key for the organisation is the cost of its total employment. The mix is a function of application of law and personal choice. It is not a driver of the costs of the organisation or the way in which we operate. It is purely a reflection of those two things.

Mr FERRALL - In relation to the table, it also includes an accrual for annual leave, in the long-term benefits. You end up with an accrual but you can also end up with a negative in situations in which people take long leave or accrued leave benefits. That can distort the comparisons between one year and another because it can simply be an accrual of a leave entitlement. Conversely, you could find that there is a negative in there if somebody took a period of long service leave.

Mr GUTWEIN - If you drop out the termination or other long-term benefits, the difference between total remuneration for the executive team in 2016-17 versus the year we are exploring now is exactly 2 per cent. There might be a different mix. It has been explained in super and the tax but the total remuneration change across the organisation was right on 2 per cent.

Mr VALENTINE - The TT-Line investments, prepayments for the vessels, are going to a UK company because it has to be invested in the euro. Is there no way that can happen within Australia? Is there a risk associated with doing it this way?

Mr ROCHESTER - Like all these things, financial markets can be complex. The difficulty we are faced with future payments in the euro is that they basically have negative interest rates. To hold an amount of money to be paid in the future costs you money. That is why we split it up into two parts.

Mr VALENTINE - What sort of level?

Mr ROCHESTER - It is 0.4 per cent on an annual basis because these are wholesale amounts of money. You are talking in the tens of hundreds of millions. We broke it up into two parts. The first part was the deposit, which we did as a forward foreign exchange transaction because we knew the TT-Line wanted that payment to be made on a specific date -

Mr VALENTINE - Is that \$80 million or \$120 million?

Mr ROCHESTER - It is the \$80 million. It costs money to put that in place. The cost of the negative carry for the larger payment, the \$120 million, was significant. Instead of looking at the forward foreign exchange market, we look at whether we could purchase a bond that was denominated in euros that would generate a return rather than have a cost of carry with it. A conventional business would have stuck with the foreign exchange contract because that is the traditional way of doing it, but because of our capacity in the marketplace we had the capacity to purchase a euro bond and generate a positive return out of it, which is what we did.

Mr FERRALL - Compared to doing this in the traditional manner, our estimate is that it is an \$8 million gain for TT-Line in undertaking the foreign currency exchange as we have.

CHAIR - I am sure you have read the Auditor-General's summary -

Mr GUTWEIN - I don't have it with me, but -

CHAIR - I can lend you a copy if you would like to follow along. In his report -

On 30 June 2017, TASCORP held \$40.1 million related to the TT-Line Vessel Replacement Fund or VR fund. The arrangement was structured as a bare trust. TASCORP was the trustee under the arrangement and the investor manager for the VR fund under a separate investment management agreement. While TASCORP was the investment manager of the VR Fund assets, TT-Line had beneficial ownership of the VR Fund's asset -

This is what you have been talking about, '... including exposure to all risks and rewards.'

I want to ask a couple of questions to make it clear. How did TT-Line become the beneficial owner? The dividend was paid by TT-Line to the general government initially. Did the money not really belong to the general government, as in the case of every other time a shareholder receives a dividend? It went from TT-Line to the government and the government sent the money across into this fund set up under legislation passed. How did the TT-Line become a beneficial owner of the money again, particularly when you think about a bare-based trust? The money is owned by the government and, when you read the act, it is pretty clear they used the government's money, not TT-Line's money, when it was sent to TASCORP.

Mr FERRALL - To be clear, funds are not in a bare trust any more.

CHAIR - Why were they put there in the first place?

Mr FERRALL - Initially, TASCORP had advice from its legal adviser to structure it in that manner and that is how it was effectively put into that bare trust.

CHAIR - Even though it wasn't TT-Line's money?

Mr FERRALL - We then subsequently reviewed that, changed it and basically moved out of the bare trust. It should not have been in a bare trust in the first place. That is the direct answer to your question. That came about because of the legal advice we had at the time from TASCORP's lawyer -

CHAIR - I see, legal advice is not always accurate, is it?

Mr FERRALL - It is not always helpful.

CHAIR - What you are telling me is that it should not have been done that way.

Mr FERRALL - Correct, and when we went through that and identified that it was structured in a way that was appropriate according to our lawyers, it was not appropriate according to how the transaction should have been structured.

CHAIR - They always knew it was the government's money, not TT-Line's money, at that point?

Mr FERRALL - I think the answer to that is yes, but maybe they did not understand it fully.

Mr VALENTINE - Fifty per cent of lawyers are wrong at any one time, you know that.

CHAIR - The legislation, as enacted, is still relevant then because it did not provide for that sort of approach. Is that what you are saying?

Mr FERRALL - I do not want to defend lawyers, but the legislation did not require or need a bare trust in order to meet its requirements. The advice we had earlier on from the lawyer was that this is an appropriate structure to put it in but, as I said, subsequently -

CHAIR - Going back to the Auditor-General's comments, as you said -

In December 2017 the bare trust was unwound. TASCORP became the investment manager for the VR fund under a separate investment management agreement. TASCORP continued to have fiduciary duties of investment manager of the VR fund's assets under the investment management agreement, while the Public Account had beneficial ownership of the VR fund's assets, including exposure to all risks and rewards.

Is TT-Line no longer the beneficial owner now, or is the Government? Who is the beneficial owner of these funds, which is effectively under the act?

Mr GUTWEIN - The act is quite specific in what those funds can be utilised for.

Mr FERRALL - To be clear around the bare trust, that was part of the challenge of it, from a legal perspective, saying it can only be utilised in a particular manner in accordance with the act.

CHAIR - To continue on with the Auditor-General's comments -

During 2017-18, TT-Line invested \$40 million into the VR fund. In May 2018, TT-Line entered into a construction contract for the two new roll-on, roll-off ships to replace the existing *Spirit of Tasmania* vessels.

Why did TT-Line pay this dividend if it was then almost within weeks to pay the deposit? Did they not know they were going to do that?

Mr GUTWEIN - Going back one question when Mr Rochester was talking about foreign exchange matters, I said to this committee two years ago, I think it was, that TT-Line's role is to be very good at running ships.

CHAIR - Not looking after money though, apparently, according to you.

Mr GUTWEIN - TASCORP's role is to manage money and that is why the arrangement was put in place. As indicated in answer to a previous question, by managing the FX issues there is a beneficial upside to the TT-Line of about \$8 million.

CHAIR - They couldn't have done that themselves with good legal financial advice?

Mr GUTWEIN - Again, their role and responsibility is to run a shipping line. TASCORP's role and responsibility is to manage money on behalf of the state.

CHAIR - I could argue, and others might, that there is a dividend paid to government; it comes in at the top and improves the government's bottom line, goes to TASCORP and comes back as an equity transfer without a negative impact on the government's bottom line.

Mr GUTWEIN - You are as aware of the forward Estimates for the budget as I am. We have a sensible surplus so that even if you took the TT-Line receipts out, we would still have a sensible surplus in place.

CHAIR - That is not the question though.

Mr GUTWEIN - No, but it is the implication you are making that we have used this to improve the Government's financial position.

CHAIR - When it goes in and within no time at all, it comes back out -

Mr GUTWEIN - We have talked about this for two years. At the end of the day, the TT-Line is a shipping company and they are very good shipping company. They have some very smart people who are doing some very good things for the state in that regard. TASCORP manages money. That is why TASCORP is looking after this fund.

Mr VALENTINE - Why the timing for this transfer?

Mr GUTWEIN - When we set the fund up, when the contract would be signed and when the new ships would be provided were not clearly known at that time. The intent of the Government was to establish a fund that would enable the cash to be built up over time and managed by the appropriate people within government. A contract has been signed in the meantime and we are meeting the requirements of that contract. Just coming back to that original point, TT-Line runs ships, TASCORP manages money - it seemed sensible to ensure that arrangement was in place.

Mr WILLIE - TT-Line could have given the money to TASCORP to invest without the legislative lock though.

Mr GUTWEIN - I did say in that debate a couple of years ago about the legislation that there was no legislative lock on the Superannuation Provision Account, and one side of government spent every dollar that was in that.

CHAIR - Going back, you said that \$81 million was sent across to TT-Line as an equity transfer from government to facilitate the payment of the deposit. Where is that actual account? Is that account with TT-Line when the money was sent back to them to pay the deposit? TT-Line's balance sheet, when you look at their annual report - and I did go to their annual report because it is all intricately linked here, and I am sure you would be aware of those aspects, too, because you are the shareholder minister of TT-Line as well - their balance sheet shows cash of \$198 million and note (4)(d) on page 73 of their annual report shows \$141 million sitting in a non-interest bearing account. Is that the deposit money that went across and is sitting there now, or what is happening with the money now?

Mr GUTWEIN - The contract was signed and the deposit to be paid once all conditions precedent had been met. The reason the money would be in TT-Line's account at the end of the year was that obviously some of those conditions precedent had not been met at that particular time.

CHAIR - So money still sits with TT-Line?

Mr GUTWEIN - Until the conditions precedent are set and the contract has been signed. There are conditions precedent to be met.

Mr ROCHESTER - TT-Line has a forward foreign exchange contract with us and we have the obligation to pay the euro when the deposit is paid, while the contract is with TT-Line, the money is actually sitting in TASCORP-

CHAIR - Where is the bank account in your financial statements, or isn't it?

Mr ROCHESTER - It will be in cash.

CHAIR - It is sitting in cash in the TASCORP statements?

Mr ROCHESTER - Yes.

Mr VALENTINE - Who pays the 4 per cent for the holding?

Mr ROCHESTER - It is embedded in the forward price of the forward exchange contracts.

Mr VALENTINE - It basically comes out of the \$8 million gain?

Mr ROCHESTER - They are two separate transactions, but, yes, there is a cost in the forward foreign exchange contracts, and that was recognised in the pricing of those. There is a positive return out of the euro bond which will not be determined until that is actually paid in 2021.

CHAIR - Where is the liability if the money is sitting in cash? I notice there is a creditor's note 18 on page 45: unsettled transactions, \$139.3 million - is that where it sits in terms of TASCORP?

Mr ROCHESTER - It is both an asset and a liability for the two legs, yes.

CHAIR - That is the offsetting amount - investments in the cash and this is the other side of the -

Mr ROCHESTER - The obligation to make the payment on the future date.

CHAIR - I am just trying to trace the money.

Mr FINCH - I have somebody who is used to reading annual reports and they had a look through this one for TASCORP. His observation to me was that some of the costs for running TASCORP are obscure. He said he felt that wages, administration, rent - those sorts of things - were hidden. He could not find what they cost. We know there is \$6.8 million to manage it. I am wondering if I could get an opinion of whether that is wide of the mark, whether those figures are in the annual report, or whether some review needs to be done of the annual report having more detail.

Mr FERRALL - I disagree the accounts are obscure. They are put together in accordance with accounting standards and audited by the Auditor-General. If the Auditor General is concerned with obscurity, he would make a comment. I would disagree with your learned friend.

Mr FINCH - That is okay. He was really trying to find out what does it cost.

Mr FERRALL - Administration on page 38 of the accounts.

Mr GUTWEIN - I was going to refer you to note 5.

Mr FINCH - I had not finished what I was going to say. How much does it cost and if we made a comparison with other states, is there any benchmarking of what TASCORP does? There are corporations like TASCORP every state, is a comparison made to see we are managing figures and that our costs of running the business are comparable?

Mr GUTWEIN - I will let the chair answer. To come back to the issue of whether the accounts are opaque or not, for the benefit of the committee there is a breakdown of the operational costs in note 5 on page 38 showing salaries, IT and communication, legal audit and professional services, premises, travel and other expenses. Your question about benchmarking is another matter and the chair and CEO -

Mr FERRALL - There are similar CBA entities for all states, except for Northern Territory. Where they have are embedded, it is almost impossible to make direct comparisons. If you look at the scale of CBA in New South Wales, Victoria or even Queensland - Stephen has experience from Queensland - as compared to the scale of TASCORP. We have 16 people and Queensland has 250.

Mr FINCH - Twenty-five per cent of whom are female?

Mr FERRALL - Approximately yes. Queensland, say, 250 people. They also have a range of differing functions across different jurisdictions. They do not all operate entirely the same. We can make comparisons in a direct sense whether our salaries are similar or below. In that respect, our salaries are quite significantly below the other CBAs.

Mr ROCHESTER - Less than half.

Mr FERRALL - That is at an individual level.

Mr FINCH - Another suggestion, how would we go outsourcing TASCORP? Do we need to retain it as a Tasmanian entity? Could you outsource the work of TASCORP to, say, Macquarie Bank or NAB or something like that?

Mr FERRALL - No, because they would not be a central borrowing authority for a state. You could potentially utilise the services of another jurisdiction, but they will effectively clip the ticket for the privilege. We go to the market as the sovereign state of Tasmania and borrow domestically and in European markets. If another entity did it on our behalf, say Macquarie, they would still be doing it on behalf of the sovereign of Tasmania. If you went to another jurisdiction and Victoria acted on our behalf, apart from under the financial arrangement, I am not sure how we could even make it work.

CHAIR - But aren't they are a government department, not a separate standalone government business?

Mr FERRALL - They have a CBA. We would basically have to get them to borrow on our behalf and then they would charge us a margin that would be appropriate to our credit rating and credit risks. In an answer to your question, those things are potentially possible, but not particularly easy to implement in the current arrangements. There are some things in terms of the original financial agreement which would make it almost impossible for us not to have a CBA.

Mr FINCH - While I am talking about the report read elsewhere, they thought it was a very good website for TASCORP. However, I notice down the bottom there is a reference to a Melbourne IT company. Why would we outsource our IT work in this instance to a Melbourne firm?

Mr FERRALL - Stephen can you take you through the two main systems. They are systems we do not have an equivalent for in Tasmania. These are specific financial systems and not something our local IT firms generally support. We have to have particular systems in order the engage with the financial market, and they are not built or designed in Tasmania.

Mr ROCHESTER - It is as simple as that. They are very complex systems and operate in international financial environments. They have to comply with the accounting standards and settlement laws of the world. Only a handful of systems can do that and we can use some support from people in Tasmania, which we do. The systems are globally based systems used by all the players around the world.

Mr VALENTINE - That is not to say there are not any globally based IT experts in Tasmania, because there are.

Mr ROCHESTER - We use those to the extent to which we can access people with the skills needed for those systems here.

Mr FINCH - I still feel we might be able to attract and develop this in Tasmania.

Mr ROCHESTER - To the extent to which we can operate it reliably and meet those standards and quality, that would be our objective. The capacity is very limited. Our scale is so small relative to the rest of the market.

Mr WILLIE - Minister, I have a list of government business enterprises and state-owned companies that have borrowed from TASCORP. How many of them are operating under a letter of comfort and if there are any, can you please name who they are?

Mr GUTWEIN - I can provide the list. Hydro Tasmania, Tasmanian Irrigation, Tasmanian Railways, Tasracing and TT-Line have a letter of comfort.

Mr WILLIE - Were any of those organisations operating under a new letter of comfort in April 2018.

CHAIR - Why was this required?

Mr FERRALL - Because we went into the significant borrowing for the new vessels.

Mr GUTWEIN - That would have been at the time of the signing of the contract, because their borrowings will increase over time.

CHAIR - Is the TT-Line the only new one over this financial year?

Mr GUTWEIN - I am happy to give you as much detail as I can. Hydro Tasmania

CHAIR - If Hydro Tasmania's performance has improved, as we note, why do they still need theirs?

Mr FERRALL - From a TASCORP perspective, we review the requirement for letters of comfort on an annual basis. We review the performance of the company entities. With Hydro, it is something we are currently looking at and we are going through a review process.

In relation to the letters of comfort, the board position is like a banker. They look at not only a current performance, most recent performance, but also at a projected performance, and to the extent the board is comfortable the projected performance might be continuing at a better or higher trend, we would consider whether or not we needed to retain the letter of comfort. From purely a board perspective, in any entity one year of trading performance is important, but it is not the only consideration in relation to whether we would say we still want to retain a letter of comfort from the Treasurer.

CHAIR - As I understand, TASCORP as the lender would request a letter of comfort from the Treasurer, if TASCORP were concerned about being able to meet its obligations?

Mr FERRALL - In some cases the process almost happens in parallel. We have ongoing dialogue with all the entities but none of these, but if there were an entity that wanted to increase

its borrowing next year, would have a reasonable understanding of what our position would be in relation to whether we may require a letter of comfort.

CHAIR - Is there a benchmark, a certain gearing ratio or is it case by case?

Mr FERRALL - We look at them to ensure they are investment grade, from our perspective.

Mr WILLIE - Is it similar to property, where the security of the assets is used?

Mr FERRALL - We basically don't have security. We don't have a mortgage over assets. We are an unsecured lender but we base it on the performance of the entity and the projected performance.

CHAIR - The other letters of comfort, I cannot remember all the companies, but Irrigation Tasmania was one, and TasRail. None of those is new, so are they all being reviewed?

Mr FERRALL - We review them continually. We do all of them annually.

Mr ROCHESTER - It is an annual cycle. They can be at different times.

CHAIR - Is that done at this time of year? When is it done?

Mr FERRALL - It is spread across the year, depending on the requirements of that business.

Mr ROCHESTER - If they have an increased borrowing requirement part-way through the year, we will update it then rather than wait.

CHAIR - TasNetworks is not on the list.

Mr ROCHESTER - No.

Mr VALENTINE - Do you offer them to local government sometimes, too?

Mr GUTWEIN - We haven't issued any letters of comfort for local government. We do an assessment of local government borrowing. Some very strict metrics are run.

Mr WILLIE - Is the irrigation scheme agreement linked to the next tranche?

Mr GUTWEIN - That was put in place in 2015. It depends on the final capital into the next tranche and what happens at a federal level, because we will need their support for the next tranche. We will discuss that with the business as and when it arises.

CHAIR - Going back to TasNetworks, I understand from the budget papers, from memory, that they are looking at borrowing another \$200 million in the next year or so. Their gearing ratio is already pretty high. Will that bring them to a position of requiring a letter of comfort?

Mr GUTWEIN - That is a matter for the board at the time. TasNetworks' gearing ratio is in the middle of the pack when compared with like businesses, broadly speaking.

CHAIR - I understand, but it is still pretty high.

Mr GUTWEIN - They are not extended. That will be a matter for the board and TASCORP when they consider this kind of matter.

Mr WILLIE - How long do you think the TT-Line letter of comfort will need to be in place?

Mr FERRALL - The board will require it to be in place until it doesn't require it to be in place. We will do annual reviews and consider it on an annual basis, but I cannot estimate whether it will end in one, two or three years time. That is the nature of letters of comfort.

Mr VALENTINE - As to TT-Line's capacity to manage investments of their own, do they manage things such as that reasonably large investment of the down payment, or other investment funds that aren't so large?

Mr ROCHESTER - They manage their cash balances, the day-to-day cashflow.

Mr GUTWEIN - They do so in the same way any other business would.

Mr VALENTINE - They are not overtly restricted from managing their own investments?

Mr GUTWEIN - No. Every business would manage its cash on an ongoing basis.

Mr VALENTINE - I wondered whether there was a certain level they could go to in investing funds and if they have to come to you for anything more than that.

Mr FERRALL - No. It is important to note, when you are talking about an individual entity managing funds or borrowing, that the reason you have a central borrowing authority is because of their expertise and that there is a global or whole-of-state benefit in doing so. If you disaggregate within a small jurisdiction like Tasmania, all your investment functions and potentially all the borrowing functions allowed to individual entities, it will cost more. It also creates -

Mr GUTWEIN - You get a lower return.

Mr FERRALL - Yes. It also creates risks to the state because they are not managed and coordinated on a central basis. It is important we maintain a central borrowing investment authority in a jurisdiction like Tasmania.

Mr VALENTINE - Thanks.

CHAIR - I would like to go to the TT-Line foreign exchange risk on page 32. I assume the unsettled transactions are predominantly related to that? Is the \$139 million related to the TT-Line money or there are other things that fit into that? You talked about the account in euro and the challenges. You created a hedging arrangement to deal with some of that risk. We will come back to that one about the unsettled transactions, if you like. Has the whole amount been hedged or is it only the deposit?

Mr ROCHESTER - In the euro part of the foreign exchange, they all relate to TT-Line. The FX transaction has been hedged and the final payments have been hedged.

CHAIR - The whole lot has been hedged?

Mr ROCHESTER - Yes.

CHAIR - What is the total cost? Do we know what the total amount for the vessels will be?

Mr ROCHESTER - It will be €550 million.

CHAIR - Is the €550 million the full cost including the deposit? Has that all been hedged?

Mr ROCHESTER - Yes.

CHAIR - Is that hedging contract in TASCORP or TT-Line's name?

Mr ROCHESTER - We have a foreign exchange contract with TT-Line but the other half of that is our obligation to pay those euros to -

CHAIR - It is an account in TASCORP's name, not TT-Line's name.

Mr ROCHESTER - Yes. TT-Line is the counterparty. There is a contract between ourselves and TT-Line. They have given us Australian dollars and we pay the euro into their bank account. The way we have hedged that obligation to pay the euro into the nominated bank account, depending on the date, is, in the short-term, for a deposit through a foreign exchange contract we have written at the marketplace. For the final payments, we hold a euro bond that will mature prior to the date of those payments. That will then go into our euro account and we will transfer it from our euro account to the ship constructor on the date.

CHAIR - In the way you have managed it, you haven't had the negative impact of having the costs associated with an account in euros. When this is paid there will be a benefit of \$8 million, did you say?

Mr ROCHESTER - In relation to the euro bond, it will depend on the timing. Due to the negative cost of carry, it depends when the settlement date is in relation to the maturity date of the bond. The longer that date is, it will erode some of the benefit.

CHAIR - What is happening with the euro? I don't watch it.

Mr ROCHESTER - The best way of describing it, and I know this is a bit blasé, is that it is up and down. The longer term driver is the time and extent to which Europe will start to unwind its quantitative easing policies, all of which are uncertain. It is up here, down here and back up there at the moment. We cannot predict markets.

CHAIR - You don't know what you are going to end up with?

Mr ROCHESTER - No, but we know the obligation is to pay in euro and we know we hold about \$8 million to \$10 million more than that in the Australian dollar equivalent at the present time. When we get to the end of it, that will determine how much of that -

CHAIR - This may be a question for the TT-Line and I accept that if it is. Payment deposit is one thing but paying for the vessels is the other. If you know what you know with the euro, and

you know what it is likely to be but if it is going to be an unknown period and it could go either way, do we have a time frame for that?

Mr ROCHESTER - Yes.

CHAIR - What is that time frame?

Mr ROCHESTER - I would have to go back to the records for the actual date. In the forward foreign exchange contracts, the constructing body has indicated they don't want the money at the moment.

CHAIR - Until the completion?

Mr ROCHESTER - No, at the present time. They keep on deferring the date.

CHAIR - Because of the value of the euro?

Mr ROCHESTER - Yes, because they do not want to have to pay the cost of holding the euro.

CHAIR - Oh, right. It is a bit of a Mexican standoff, isn't it? Maybe we could have the money or something, to use it for something else.

Mr ROCHESTER - We have. It is sitting in the account bearing a cost.

Mr VALENTINE - Eight million dollars.

CHAIR - Potentially being eroded.

Mr ROCHESTER - Yes, the deposit is the relatively smaller amount and it will come to its conclusion. As for the euro bond, we are making money out of it. We are not subject to those same risks.

CHAIR - Going back to note 18 and your payables, the unsettled transactions, can you give us an explanation? I know part of that is the TT-Line component, but is there anything else that relates that is significant?

Mr ROCHESTER - No, it is just the normal ebb and flow of the business.

CHAIR - The difference between the 2017 \$5.5 million and \$139 million is effectively just the TT-Line money. Is that what you are saying to me?

Mr ROCHESTER - Yes.

CHAIR - Thank you, I just wanted you to clarify that.

Mr VALENTINE - I am obviously not an expert, but I am interested in how much offshore investment you have overall in your portfolio of investments and what percentage would be offshore.

Mr ROCHESTER - Pretty well close to nil.

Mr VALENTINE - Except for the TT-Line?

Mr ROCHESTER - There is the euro in the euro account. The euro bond we issued was issued by an Australian bank so I am not too sure how you classify that - a foreign currency issue.

Mr VALENTINE - That was the question I was asking before, why didn't we keep it within Australia to lend out, but you have confirmed that is what we have done. Thank you for that. That clarifies that.

CHAIR - With regard to your overall business, I know we have focused a lot of time on the Mersey money and TT-Line, but they are aberrations from past years. What is the take-up of bonds and when do you issue them?

Mr ROCHESTER - I suppose there are two components to this. The first and primary one is when do our individual clients want the funding? That will depend on their own particular businesses, and given that TasNetworks and Hydro are our largest borrowers, they are really the prime determinants of it. We separate the provision of the funding to our clients from when we will issue into the marketplace because we do not want to be caught with a client saying they want to issue \$200 million today and the market says no, there has been an event in America and investors do not want to buy. We will typically issue three, sometimes a bit longer in advance of customer requirements. We will hedge our funding of those on our books ourselves. It is just that cycle of what is the requirement of each customer. We have very good relations with each client. We know and understand what their funding strategies are. Then we have the conversation with the market about what the market appetite is and we basically look for windows where we can issue and get the lowest cost of funding, hold that on our books and hedge it prior to the customer or client requiring that funding. That is a cycle it goes through each year.

CHAIR - That is your job. Another thing that is evident is that there is a Treasury management system, which is run by a third party - Quantum, I understand - that TASCORP uses. I understand that is hosted in the Cloud. I am just interested in what sort of security there is around the management of that data and how you keep an eye on that, given that data theft is significant around the world?

Mr ROCHESTER - We chose the system not just because of its business application, but also because of its security characteristics. It does not operate in the Cloud in the US or environments where the Cloud would operate that would create unmanageable security issues for us. We have gone through that process. In fact, we appointed an independent assessor to review those issues, given that is not our daily bread-and-butter. As for everyone who operates IT systems, there is always a risk someone will come up with a way of compromising it and we have a constant process of going through a review of those issues.

CHAIR - So there is a constant security risk assessment on those aspects of your data storage?

Mr ROCHESTER - Yes.

CHAIR - Are there are covenants in place with companies that you lend to at the moment?

Mr FERRALL - No, we lend [inaudible].

CHAIR - No? This is a matter that the Auditor-General raised. There are no covenants?

Mr ROCHESTER - None that rings a bell immediately.

Mr FERRALL - With our individual clients there are -

Mr ROCHESTER - We have a facility agreement. Where we lend, we have a facility agreement with them that requires them to keep us informed and to meet certain requirements depending on the nature of those businesses. They may be ratios or changes in asset levels.

CHAIR - Have there been any breaches of any of those requirements - for example, with interest rate cover? Have you noted any breaches in the past 12 months?

Mr ROCHESTER - We have some issues every now and again. Some of them are volatile, but no breach.

CHAIR - No breaches?

Mr FERRALL - Our lending agreements effectively require the entities to operate within certain parameters. As Stephen said, it could have ratios and other things. We do have regular occasions where our clients come to us and say they are not operating within that parameter at this time, or they are projecting they are going to exceed that particular parameter for a period. When that occurs, the board considers it and works through whether - using your language - it is a breach in terms of something we want to take serious action on because it is a breach of concern, but it is a breach of our lending covenants effectively if they have exceeded some of those things. The answer to your question 'Are there any breaches?' would be yes, but it really depends on what action the board decides to take in relation to it. Some of them could simply be a particular metric and a particular spike or change in a -

CHAIR - Like a cashflow issue or something like that?

Mr FERRELL - Yes, but it would be a breach.

Mr ROCHESTER - The recent ones have been projected breaches, as distinct from actual breaches.

CHAIR - If they think they might be going to breach, they will let you know - is that what you are saying?

Mr FERRELL - Yes, because they have a requirement to keep us as their lender informed. By and large, our entities are pretty good at that and they say, 'We have looked at our cashflow over the next four months and we think there is a potential for us to breach one of those covenants in three months time.' We would consider that and say that is something we are concerned about or something we are not.

CHAIR - Are local governments among those businesses or organisations that fall into that category at times?

Mr FERRELL - No.

CHAIR - They are good or are essentially meeting their requirements?

Mr ROCHESTER - Very few of them borrow.

Mr GUTWEIN - Local governments have very low levels of borrowing.

CHAIR - Which of the government businesses or SOCs are the ones you find more likely to come with a complaint?

Mr FERRELL - I do not think I can say 'more likely'. I would have to take on notice those that might have advised us in the last six or 12 months because I cannot recall all of them and I do not want to try to guess them.

CHAIR - It would be helpful to know because it is a bit like the letter of comfort. At least they are letting you know if they might or will breach -

Mr FERRELL - That is the whole purpose of the covenants: we are informed by them and there is a metric where they know they need to inform their banker of a change. It is not dissimilar to what you would see in a normal banker-client relationship where a bank effectively says, 'If these things change, please inform us'. That is how we work. Our clients are better than other banking clients because they are part of Tasmania Incorporated and tend to act quite reasonably.

CHAIR - I want to focus on key person dependency risk at the moment, particularly with the management of the TT-Line money in foreign investments. Understanding what is obviously a complex area, is there a risk of a key-person dependency in this area or any other areas within the business, because they are specialist skills and we struggle to understand a lot of it? I know I do.

Mr FERRALL - The answer to that is 'yes' there are key person dependencies, because we are a very small organisation and so there are risks. That is mitigated internally by having separate teams, with back-up and support in relation to those teams. But again, when you are talking about 16 people and 'How big is the team on FX?', it is pretty small.

We do have those risks. We manage them, but it is not something you can avoid in a small organisation. Again, from a board perspective, while we have key person dependencies, we adopt a fairly rigorous approach to the risks of those dependencies. In relation to things like, say, the Mersey fund as an example, we had a third-party review of what we were attempting to do in relation to Mersey. We ensure not only the risks of an individual leaving are covered, but also the risk of an individual not knowing enough, covered by insuring we have a third-party validation of high-risk areas.

Mr VALENTINE - Do you have knowledge-based systems operationally in place? Like Atlassian software which helps people place their knowledge into a software system that can then be accessed by others if a person is off sick?

Mr FERRALL - We have very regimented and rigorous policies and procedures of what people need to do in relation to their daily activities and operations. This is covered, but in terms of the pure knowledge base -

Mr ROCHESTER - We are looking at it and trying to work our way through it.

Mr VALENTINE - Yes, that would be great.

Mr ROCHESTER - It would be, but because we are such a small organisation, the things that make sense for Coles, Woolies and the banks do not necessarily make sense for us. To compensate, we have, as the chairman pointed out, a very rigorous process of basic policy and process documentation.

Mr VALENTINE - Health IT has one.

CHAIR - I do not necessarily want the banks to give us too much advice at the moment.

Thank you, Treasurer, we have run out of time. I appreciate the time you have given us and the information. We will request a couple of things in writing to you, notifications for potential breaches for the lending covenants and the modelling for the Mersey money, but, other than that, we appreciate the information provided.

Mr GUTWEIN - Thank you.

The committee suspended at 12.19 p.m.