

TRANSCRIPT OF PROCEEDINGS

National Judicial Staff Services  
Supreme Court  
P O Box 7018  
BOROKO. NCD  
PAPUA NEW GUINEA

Tel: (675) 3245 792  
Facsimile: (675) 3257732

COMMISSION OF INQUIRY INTO THE NATIONAL PROVIDENT FUND

Mr Tos Barnett, Chairman  
Mr Donald Manoa, Commissioner  
Lady Wilhelmina Siaguru, Commissioner

AT WAIGANI, MONDAY 14 AUGUST 2000 AT 9.40 AM.

(Continued from 10 August 2000)

[9.40 am] THE CHAIRMAN: Good morning. Are there any preliminary matters or should we get started, just continue on with the ANZ borrowing?

MR BATARI: Yes.

THE CHAIRMAN: Nothing from you? Nothing?

MR WARDLEY: No. I have just got a couple of preliminaries which will need addressing some of the queries last week.

THE CHAIRMAN: Thank you, yes. Mr Wardley?

MR WARDLEY: Good morning, Chairman, Lady, commissioner. During the hearing last week you asked a number of questions which I was unable to answer. Having consulted with my team, I would now like to address the points raised. Firstly, you requested a glossary of terms. This will be provided at the end of the presentation. You also queried a drawdown of K5 million. At this stage we are still carrying out our ongoing researches into which investment that related to.

In addition to those questions I would also like to draw your attention to two additional items of evidence that we will be tendering concerning ANZ's December 1997 audit memorandum. The documents I refer can be found in commission document 459. My team have only just come across these. In our opinion these are relevant documents that provide evidence as to the level of vigilance, monitoring and review processes undertaken by ANZ Bank.

I would request permission that these diary notes, and memorandum are taken as read into the transcript. These documents will be tendered as document B1410AB and C. We would also like to note that at the bottom of 1410A was annotated the following: "MD comment. I can assure you that minister is guided by David Copland. And in any change of minister I would believe the status quo remain. However comment is justified."

[9.42 am] THE CHAIRMAN: Okay, thank you. So, now, what are you actually requesting that I should do right now with regard to tender documents B1410A, B and C?

MR WARDLEY: That they be read into the transcript rather than me read them out verbatim.

THE CHAIRMAN: Okay, do you have copies of them here?

MR WARDLEY: I have copies of them here, and the transcript. They have already been passed out.

THE CHAIRMAN: All right, thank you. Well, I direct that tender documents B1401A, B and C be read into the transcript and incorporated therein. Thank you.

"To: Mr R A Cooney  
Senior Manager  
International Credit Operations

Mr R G Lyon  
General Manager  
Pacific

From: Ahmed Hafeez  
Manager  
International Credit Operations

Date: January 2, 1997

Subject: **National Provident Fund (NPF)**  
PNG CM of 23/12/96

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### **Purpose**

Credit Memorandum recommends the following:

- Increase existing AUD loan by AUD 20.0 million to AUD 40.0 million.
- Variation to existing security arrangements (see below)
- Interchangeability between the two limits

### **Comments**

Background and current position on customer are well summarised on pages 10-12.

Facilities are currently on the basis that PGK limit is covered by either PGK cash and kind and/or AUD shares (Australian listed) @ 190%+ and AUD limit is covered by AUD shares @ 150%+.

It is now proposed to increase the AUD limit to AUD 40.0 million and provide complete interchangeability with the existing PGK 40.0 million limit. Drawings in either currency are to be secured as per existing arrangements. The key difference being that not only is the PGK cash/kind security for the PGK component diluted with the increase in limits, it could also possibly cease to exist. However, the margins held against AUD shares (securing both facilities, PGK @ 190%+ and AUD @ 150%+) are fairly large and marking to market is weekly.

The past year or so has been a significant growth in equities investment and along with it in facilities. NPF has invested heavily in PNG Companies' shares (listed in Australia) whereas, it traditionally used to invest the larger part its portfolio in Government Securities and Term Deposits. The move to equities and other high yield alternatives has so far been prudent, albeit a rapid one. The equities portfolio comprises a few well known companies and recent additions have diversified it from one heavily concentrated on mining stocks.

NPF's investment strategy is driven largely by the current Finance Minister, who retains a key involvement in decision taking (any decision for sums exceeding PGK 0.3 million require his approval). Management, especially the MD and Financial Controller are highly regarded individuals. However, the involvement of the Minister needs to be kept in perspective and while it is acknowledged that so far NPF has performed well, the kind of activity it is now significantly involving itself in is best managed and led by professionals.

On surface the planned Real Estate development project is considered an effective (perhaps even necessary) way to balance the portfolio profile. While a non-committal interest has been expressed, the level of facilities now proposed is considered close to the maximum and NPF should be encouraged to bring in other tenders.

### **Recommendation**

The increase has been sought from ANZ on the strength of the good relationship and a better management of FCY facilities and is supported on the basis that it represents the Bank's maximum appetite at this stage. Interchangeability is also supported as it allows a better management of customer's needs without materially altering risk, given the high margins on security.

**Ahmed Hafeez**  
Manager

### **Technical**

- Discretion usage (this increase) to be reflected as the first increase since 1/1/97
- Upon receipt of audited financials, one set of spreadsheets should be prepared re-stating investments at cost and eliminating the charge to P&L, for comparison purposes and analysed accordingly (discussion Frazer/Hafeez refers)

### **Senior Manager ICO's comments:**

It is imperative that the full consequences of this exposure are well understood. I too am of the view that the Minister of Finance has an involvement to an extent that can be considered excessive. Apart from the obvious need for the Bank to ensure at all times that the relative legislation is being complied with. There will always be the possibility of ANZ (and others) being tagged as assisting any loss making investment activity.

While accepting that a change in the Investment Guidelines is likely, an unexpected change in Minister could mean something entirely different. It would be my expectation in such a scenario that rectifying steps be taken within the shortest reasonable timeframe. Continual monitoring to be maintained and we should expect any breach of security cover ratios to be rectified within 2/3 days.

It is too early to express a view on the planned real estate development. Certainly any interest would be considerably diminished if participation would require PNG Country Limit.

R A Cooney.

Date 24TH DECEMBER 1996

To SENIOR MANAGER  
INTERNATIONAL CREDIT OPERATIONS

From SENIOR CREDIT MANAGER  
PNG ADMINISTRATION

**RE : NATIONAL PROVIDENT FUND  
CM DATED 23/12/96**

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CM is presented for consideration and bears the dual support of Managing Director.

The credit, and accompanying covenants, in our view, represents a satisfactory risk for ANZ in PNG, notwithstanding, we acknowledge this increase represents a substantial exposure to a

single counterparty. At the same time, our risk is mitigated by the diversity of the NPF portfolio with representation in Mining, Retail/Wholesale trading, Government Securities and cash/IBD.

The prospect of becoming involved in the NPF building project, during 1997, leaves us lukewarm at this stage. The project may or may not become a bankable prospect in time but additional, significant increases to this counterparty should be resisted past this point.

Breaches of, both ANZ covenants and BPNG prudential guidelines, are detracting features of this relationship. If we are to go forward, we need to take a pro-active position in the management of that relationship ----- additional covenants seek to impose ANZ's position and the relationship management will need to be strong.

Supported, subject to:

- NPF gearing is not to exceed .60:1 ----- determined by total liabilities: Members' net equity.

With access to all funding lines, gearing is nominally .55:1 ----- some tolerance is provided for trading purposes.

- NPF management is to provide quarterly management data evidencing compliance with all loan covenants. Requirement is a deviation from existing 6 monthly presentation of data. Compliance certificate is to be presented within 45 days of quarter end and signed by at least 2 members of Boar of Trustees.

**JOCK .J. FRAZER**  
**SENIOR CREDIT MANAGER"**

MR WARDLEY: On Friday we finished at half way down page 115 of my notes and that is where I wish to continue from. We were talking in respect of a credit memorandum update. At the end of 30 June 1997, ANZ diary note, commission document 457, page 362, records that the annual credit memorandum dated 30 June 1997 had been approved by the International Credit Operators. Again, however, we note that ANZ ICO provided this approval subject to resource related shares held as security being marked to market on a daily basis. In addition NPF's progress and risks, we can see that ANZ, was now more focussed where previous CM and DN analysis had not highlighted the risks. It is worthy of review in detail as it illustrates clearly that ANZ was closely monitoring ANZ's position in terms of security. The diary note, through short, was important for it again highlights ANZ's vigilance with regard to the resource risk exposure of NPF. The diary note will be tendered as document B1411, 1454.

[9.44 am] The credit memorandum dated 30 June 1997 is an important document within the bank as it formally records an annual review of the NPF's facilities and also to seek an extension of limit for a 12 month period. The credit memorandum pertain the following update on Vengold script: "Summary: Overall, we remain comfortable with the Vengold script security given. Shares are being regularly traded on the Canadian stock exchange. Share price has remain stable on both the ASX and the Canadian stock exchange. Balance sheet of Vengold as at 31/03/97 reveal shareholders equity of US\$65 million and cash at bank of US\$25 million; and (NB a summary of the ASX first quarter report Vengold Inc for the three months ended 31/03/97 is attached). Vengold offers NPF a better strategic position in Lihir."

In the financial analysis section of the credit memorandum, there was a detailed analysis of the financial statements for the year ended 31 December 1996. The following pertinent conclusions were drawn. At page 4 tendered document B1450 of the credit memorandum. "Prospective Trading and Cash Flow Performance. Base case financial model together with detailed assumptions is attached. The model projects surplus cash flow during 1997 of K25,776,000, after interest commitments and interest cover of 2.26:1. The model assumes that the proposed PNGBC loan recently approved to assist with the construction of NPF tower is fully drawn, i.e, a maximum loan of 50 million has recently been approved but this figure may be significantly less, refer risk controls. No allowance has been made for any income to flow from the NPF tower which is to be leased out as office space. Sensitivities performed indicate that the model is most sensitive to movements in share prices and (b) interest rates. Should share prices generally begin to fall, the fund would look to diversify away from equities towards interest rate investments and property investments."

Considering this last point briefly, we should point out that whilst the strategy of reducing holdings in equities was recorded as an option available to NPF, in practice this approach was never followed by NPF management when share prices did adversely move against the fund. At page 5 of tendered document B1449 of the credit memorandum: "In the event that the fund's interest expense rate increased significantly, NPF would look to reduce its borrowings from sale of liquid assets, IBDs, quoted shares, tradable government securities. Should the fund experience a reduction in its interest income rate, it would look to diversify away from interest rate investments towards equities and property."

Again the logical reaction to the economic environment stated was never followed partly due to the significant illiquid nature of the fund's investment portfolio. At page 6, tendered document B1448 we find the following comments and observations:

[9:46 am] Weaknesses/risks. Influence of minister of finance on fund's activities. Investment portfolio heavily weighted towards equities. Quality of scrip. Exposure to interest rate movement. Exposure to exchange rate movement. Exposure to share price movement. Risk of early withdrawal of funds by members. Strength/mitigants. NPF's strategy role and philosophy is controlled by the board of trustees which comprises a tripartite of nine individuals representing PNG government employers and employees. The tripartite nature of the board of trustees, means that the fund is not a vehicle or tool, of a political influence and that employees/employers have a significant say in the role and investment strategies of the fund. The minister of finance is guided by David Copland, chairman of NPF and in any change of a minister of finance, it is our belief that the status quo would remain.

Assets remain well spread. NPF Tower project will result in an increase in the fund's property portfolio of some K45 million to K50 million which will help to diversify the overall investment portfolio further. Steamships, Collins and Leahy, Highlands Pacific, Orogen Minerals maintain lending relationships with the senior corporate manager, PNG with customer group credit ratings of 4F, 4F, 6G and 6G assigned respectively. According to the SCBM, Orogen Minerals and Highlands Pacific are likely to be upgraded at next review to CCR5 or better. We are comfortable with the quality of Vengold scrip for the reasons outlined earlier.

Summary of the ASX quarterly report 31/3/97 on Cue Energy resources, attachment 2 gives us no cause for concern and reliance on this scrip is not deemed significant. The fund continues to generate strong cash flow. CFF projects that the fund has the ability to comfortably cover interest and other commitments as and when they fall due. Scrip is being marked to market on a regular basis to monitor share price movement. Negative pledge covenants protect against adverse movement in both exchange rates and share prices.

[9.48 am] Profitability indicators reveal a positive trend. Position remains acceptable after investments had been re-stated at cost and the charge to P and L has been eliminated. There is a large penalty or forfeiture for members who are withdrawing earlier than they should. The board is also considering introducing a reward scheme to act as an incentive for members to keep their savings invested with the fund. Sound experienced management is evident.

Summary. Probability of default is assessed as low. The fund's ability to service and repay all commitments as they fall due is evident. Customers' integrity and willingness to repay is not doubted.

Re-finance feasibility. Other ways out. Security comprises of liquid assets which could be readily converted into cash should the need arise. It is considered that re-finance would be readily achievable given the fund's strong cash flow, history of profitability and sound balance sheet structure."

The credit management also summarised the facilities and security thereof and concluded that the risk of default was assessed as low and available security adequate: "Asset writing considerations. We are comfortable with the current facilities provided given: Commitment of funds is short term subject to annual review. Ability to re-price facilities exists should the situation warrant same. Acceptable margins are being maintained from the relationship with acceptable security held.

Conclusions and recommendations. Extension of facilities on a revolving basis for a further term is recommended given. Probability of default is assessed as low given (a) risk controls in place, (b) strong cash flow performance, (c) sound financial structure and (d) well regarded

management with solid experience. Fall back position is considered reasonable given (a) accountable margin on our safety assessment calculations and risk controls in place, (b) security held is liquid and could be converted to cash should the need arise and (c) it is considered that re-finance would be readily achievable.

[9.50 am] Return for risk is considered adequate. Extension of facilities for a further term is recommended subject to (a) the continuation of existing risk controls; and (b) all scrip held as security to marked to market on a weekly basis."

The credit memorandum due 1997 was then sent to ANZ's manager of international and credit operations and the general manager of the pacific region for review and approval. The credit memorandum was approved jointly by them by way of a memorandum dated 11 July 1997, a copy of which can be found in commission document 459.

The approval was given subject: "To resource related shares held as security being marked to market on a daily basis for the time being in view of the recent market volatility relating to gold price movement." A copy of the approval memorandum will be tendered as document B1461.

On 18 July 1997 ANZ diary note, commission document 457, page 370, reference B1455 to 1456, registered a downward movement in the price of Vengold. In accordance with ANZ policy, NPF's portfolio was marked to market on a daily basis. What we mean by this is that NPF's investment holdings were revalued each day using published share market prices. Obviously this exercise was designed to detect at a moment's notice problems with the level of security available to ANZ. The requirement of a daily check indicates that ANZ was acutely aware of the volatility of the share markets on which they had taken security over.

On 30 June 1997 NPF had pledged the following security according to the credit memorandum of that date. "PNG facilities: limit, K40 million; drawdown, K8,649,000; security, Kina-based securities, deed of pledge of account K500,000' Australian-based securities in AUD\$ market value 50 million Highlands Pacific shares worth, valued 51 million; 26.15 million Cue Energy shares, market value 7,062,000; 11.5 million Cue Energy options, value 1,150,00.

[9.54 am] 1.2 million Oregon Mineral shares, value 4,465,000. The total value 63,677,000. Less 20 percent ERMR AUD\$12,735 - - -

THE CHAIRMAN: What is ERMR?

MR WARDLEY: Exchange Rate Management Risk.

THE CHAIRMAN: Thanks.

MR WARDLEY: It will be in one of those glossaries which we referred to. So, a sub-total of AUD\$50,942,000. Converted to Kina, in kina K51,451,000. EV at 65 percent, giving 33,443,000. A margin 25,294,000. That is in respect of the Kina facility, they were the 25.3 million safety margin. The security in respect of the Australian Dollar facility was as follows: Australian Dollar facility, limit drawn K40,224,000. Security coverage, 7.45 million Collins and Leahy shares, value 26,455,000. 6.07 million Steamship shares, value 20,952,000. 15.2 million Vengold shares, value 27,360,000. A total value 74,767,000 which when converted to Kina resulted in K75,515,000. The EV at 65 percent resulted in a figure of K49,085,000, a margin of 8,860,000."

August 1997. On 6 August 1997 ANZ diary note, commission document 457, page 373 records the approval for a lease of the following securities: (1) release of 11.5 million Cue Energy options. (2) Release of 1,180,400 Oregon Mineral shares. A copy of this diary note will be tendered as document B1457, 1458.

On 7 August 1997, ANZ diary note, commission document 457, pages 375 and 376, records that the manager, business banking, Mr Jenkin, had a meeting with Mr Wright at NPF's head office. This diary note inter alia shows consistent with the sentiment expressed in the credit memorandum 30 June 1997 that ANZ continued to encourage NPF to utilise its facilities with ANZ to the maximum: "MBB today called on Noel Wright at NPF's head office. Matters discussed are documented below. Release of Cue Energy Resources option certificates. Further to diary note 06/08/97 MBB delivered 11.5 million Cue Energy Resource options to NPF and arranged for the customer to sign the scrip register.

[9.57 am] 1996 audited accounts. Opportunity was taken to obtain a copy of NPF's 1996 annual

report. As foreshadowed in our annual review CM, the accounts have been qualified by the Auditor General of Papua New Guinea. The National Provident Fund has included a provision of diminution in the financial statements of K10 million for future adverse equity market movements. This is a departure from IAS 26 accounting and reporting by retirement benefit funds paragraph 32 that all retirement benefit fund investments should be carried at fair value for marketable security and fair value is market value. In my opinion, the inclusion of the provision does not represent a fair value of multiple securities and therefore understates profit for the financial year by K10 million.

Fourthly, Compliance Certificate. The NPF Board is to meet in approximately two/three weeks time. A copy of the management accounts for the quarter ended 30 June 1997 and compliance certificate should be made available to the bank shortly thereafter.

Kina Line of Credit. Kina line of credit has not been availed of since early July 1997. In contrast, the Australian dollar line of credit is currently being fully utilised which Mr Wright attributes to the perceived cost advantage of this product over domestic funding. The Australian dollar line of credit also provides a natural hedge against currency fluctuations, ie, equity investments are all in Australian dollars.

MBB has discussed with Noel Wright the possibility of transferring all or part of the kina line of credit limit to the Australian dollar line of credit facility, ie, as a way of encouraging NPF to increase its usage of ANZ facilities. The facilities are interchangeable subject to BPNG approval and country limit availability, ie, Australia cross border risk. Noel has undertaken to raise the matter with the NPF Board when they next meet, ie, next two/three weeks.

Highlands Pacific Shares. NPF currently hold 50 million shares in Highlands Pacific. Mr Wright provided MBB with an article from Personal Investment August 1997. The key points in this article are summarised below. Highlands Pacific Limited listed on the ASX in June 1997 and issued at \$1 a share to \$1.05 in early July before closing at 86 cents on July 18.

The Brisbane based broking firm, HTM Wilson a joint underwriter of the 210 million share issue with the New York Investment House Merrill Lynch has issued a comprehensive 27 page report that strongly recommends Highlands Pacific as a good buy PNG politics aside. Highlands Pacific has a 65 per cent stake in the Ramu Nickel Cobalt project 75 kilometres south west of Madang and 85 per cent of the Frieda copper/gold project in far west Sandaun Province. Of Ramu Wilson believe that it has the lowest life of mine cash costs of the major new nickel projects planned. Ramu also has the benefit of excellerated tax deductions in PNG.

[10:01 am] The broker expects Ramu to have a 20 year mine live with planned output of 30,000 tonnes of nickel and 3,000 tonnes of cobalt a year. Added bonuses are the mine's proximity to the coast, public transport and a power system. The Frieda Copper/Gold project is in Wilson's words, one of the largest undeveloped copper projects in the world. Feasibility study completed last July proposed a \$2.2 billion mine to produce 220,000 tonnes a year of copper and 330,000 ounces of gold for the mine's first 13 years. In the broker's estimates, costs are low. 28 US cents, a pound for the first five years and an average of 41 US cents a pound over the mine's expected 23 year life. Wilson estimates Highlands Pacific is worth \$2.14 a share. An independent assessment in the prospectus was a more sober \$1.70 per share." A copy of this diary note will be tendered document B1459.

THE CHAIRMAN: There is a big difference between Wilson's estimates and the independent assessment.

MR WARDLEY: Yes, 15 - 20 per cent difference. Also when you compare that it was currently trading at 86 cents in July.

The first matter to note from this diary is that Mr Wright was reported as undertaking to raise the matter of utilisation of the fully interchangeable facility with the board of trustees of NPF. The second matter of significance is the commentary concerning Highlands Pacific Limited which will be reviewed in detail in a separate commission hearing which will also continue to feature in our review of the ANZ facilities because of the large sums of monies invested in this company and the pledging of those shares as security to ANZ. The third matter of note is that whilst NPF's financial statements had been qualified by the Auditor General for non compliance with relevant accounting standards, ANZ diary note did not comment upon this in terms of how this reflected on management's integrity and attitude towards compliance and financial reporting issues. Through all this, we find that there was less investment activity in respect of ANZ's facilities. The

only matter arising in the month involved share dealings in NPF's investment in Cue Energy and Orogen Minerals.

On 6 August 1997, Mr Wright instructed Mr Jenkin at ANZ to return all of the Cue Energy option scrip held by ANZ. It would appear, based on the evidence available to the inquiry, that unauthorised trading in options was undertaken by NPF through various brokers and as a consequence these transactions are under review by counsel assisting and his team. It is planned that these will be reviewed in a separate commission hearing in the near future. A copy of Mr Wright's instructions concerning Cue Energy can be found in commission document 457 and will be tendered as document B1462. Also on 6 August 1997, from commission document 457, we note that Mr Jenkin, manager, business banking sent a fax to ANZ Nominees confirming that ANZ Nominees were to release NPF's holding of Orogen shares as follows: 125,000 Orogen shares to Merrill Lynch, balance 1,055,400, to Wilson HTM. A copy of an instruction to ANZ by Mr Wright and a consequent instruction by ANZ to ANZ Nominees is located in commission document 457 and will be tendered as document B1459 to 1463.

September 1997, we note from a diary note found in commission document 457 dated 2 September 1997, evidence of ANZ's encouragement of NPF to seek increased flexibility in the available facilities by allowing the kina and Australian dollar facilities to be treated as interchangeable and therefore effectively enabling NPF to utilise the full extent of the available facilities.

[10.06 am] As NPF embarked on its investment expansion into equities, it found itself less able to make use of the Kina facility because this required this pledging of Kina assets. ANZ diary note recalls the approaches to Mr Wright: "I have spoken to Noel Wright a couple of times regarding the possibility of swinging part or all of the Kina facility across to Australian dollars with a view to encouraging NPF to increase the overall usage of their facilities. The facilities are fully inter-changeable subject to Bank of Papua New Guinea approval and country limit availability. Noel has now agreed for us to test the water by applying to the Bank of PNG to transfer, say, K20 million across to the Australian dollar facility.

Could you please draft a letter to Bank of PNG, NB, referring to the Bank of PNG's previous approvals, for which you hold copies, seeking their approval to this variation." The diary note was signed off jointly by Karen Williams, business banking analyst, and Tait Jenkin, manager business banking. A copy of the diary note will be tendered as document B1462A.

Following this, it seems Mr Wright wrote a letter to Karen Williams, ANZ, requesting ANZ to deposit K1 million into NPF's account as at PNGBC for a drawdown for Kumagai Gumi. As the commissioners may recall from the hearing of the PNGBC borrowings, Kumagai Gumi was the building contractor for the NPF Tower project. As we have seen earlier when we reviewed NPF's borrowings from BSP, NPF had asked BSP to drawdown this K1 million on their K30 million facility and BSP had refused. The need to then seek finance from ANZ is indicative of poor financial planning as well as a lack of proper financial control. A copy of Mr Wright's letter and enclosure is found in commission document 459 and will be tendered as documents B1463, 1467.

October of 1997. In early October, ANZ diary notes records NPF's request for ANZ's approval to obtain finance from PNGBC for the tower. This would later have a significant impact on NPF's financial position in 1998 and '99 with regard to its ability to service its debt obligations and meet the required security levels for its facilities with ANZ.

The diary note, commission document 457, page 382 to 385, records that ANZ received a letter from NPF regarding funding for the NPF Tower which is quoted in the diary note as stating: "As discussed, BPNG informally advised that they would not like to see The Tower borrowing go to ANZ due to our current exposure. As a result, we have given the opportunity to PNGBC. The K50 million will be used to both construct and fit out the tower. Any shortfall will be funded from NPF's cashflow. We need a release of the negative pledge with respect to borrowing in excess of K10 million from any other financial institutions." The significant issue, of course, here, was the creation of a further K50 million facility on top of ANZ's facility of approximately K80 million, K40 million and AUD\$40 million as well as loan facility with BSP of K30 million. Both ANZ and BSPs were at this time, according to the diary note, fully drawn down.

In response to this request, we note from the diary note that ANZ allowed NPF to borrow funds from PNGBC. The reasons given were: "NPF's investment portfolio is heavily weighted towards equities. The NPF Tower project will result in an increase in the fund's property portfolio and help

to further diversify the fund's overall investment portfolio in line with the investment guidelines issued by the PNG Government in 1994.

[10.10 am] The prospective trading and cash flow performance analysis contained in CM 30/6/97 assumed that the PNGBC loan of K50 million was fully drawn but made no allowance for any income to flow from the NPF Tower which is to be leased out as office space."

At the foot of the diary note evidencing his review and approval the senior credit manager, Mr Frazer signed and noted the following: "Given the recent ARCM addressed these issues without objection from ICO, I will not progress to Melb." A copy of this diary note will be tendered as document B1468.

This we take as meaning that as the annual review credit memorandum had dealt with this and as no objections had been raised by international credit operations in Melbourne, ANZ head office, further referral to Melbourne was not seen as necessary.

The borrowing from PNGBC for the tower has been dealt with in an earlier hearing, whilst the investment in the tower project will be reviewed as a separate subject in future commission hearing.

On 20 October 1997 ANZ diary note, commission document 457, page 386 records a further update in respect of NPF's investment in Vengold, where Vengold was reported as increasing its holding in Lihir and Vengold's share price was recorded as trading at CAN\$1.92. ANZ clearly had identified this investment as an investment that required careful attention. Later events in 1999 where NPF incurred losses of approximately AUD\$34 million proved that this assessment was correct.

November 1997. According to ANZ diary note 25 November 1997, commission document 457, page 390, an application by ANZ and NPF to the Bank PNG, for the approval of the transfer of 20 million of its kina facility to Australian dollar facility had been approved by Bank PNG. The facilities available to NPF were now in effect K20 million and AUD\$60 million. A copy of the diary note will be tendered as document B1470.

With the BPNG approval in place, the diary note of 25 November 1997 also records a drawdown notice from NPF for the following amounts for the investments noted. AUD\$658,000 for Orogen Mineral and Steamships Trading shares; AUD\$1,498,896 for AUD\$44,403 Steamships shares; \$573,895 Highlands Pacific; \$358,303 Orogen; \$511,289 Vengold and AUD\$11,033 Collins and Leahy shares.

December 1997. In December 1997 through to May 1998 we find that NPF continued to drawdown on the new facilities available. Referring to the ANZ diary notes these were as follows. 11 December 1997 diary note, commission document 459, page 402, drawdown AUD\$1,054,867.

[10.15 am] For 550,000 shares in Lihir Gold, AUD\$798,975. 11,985 shares in Oregon Minerals, AUD\$40,048. 117,700 shares in Vengold, AUD\$215,844.

18 December 1997, commission document 459, page 406. Draw down of AUD\$3,458,502 over 180 days for unspecified investment. A copy of the supporting diary notes will be tendered as documents B1473, 1476.

January 1998. 8 January 1998, ANZ diary note, commission document 459, page 414, records a draw down of AUD\$4,206,009 over 180 days for unspecified investment.

9 January 1998, ANZ diary note, commission document 459, page 421, records receipt of NPF's financial results for 30 September 1997 and also records negative pledge compliance certificate. ANZ's commentary on 30 September 1997 results noted slump in NPF's financial result compared to the period to 30 September 1996. However, overall conclusions were positive with no other adverse remarks noted. The diary note was copied to the senior credit manager who annotated against this note: "Please give attention to progress of NPF Tower and effect on gearing, et cetera, at next advices." A copy of the supporting diary notes will be tendered as document B1477, 1481.

February of 1998. Again from ANZ diary notes, we once more see NPF draw down from the interchangeable facilities. 6 February 1998, ANZ diary note, commission document 457, records

draw down of AUD\$74,410 and AUD\$4,944,745.

12 February 1998, ANZ diary note, commission document 457, page 430, records draw down of AUD\$184,204.

We also note from ANZ diary note that 16 February 1998, commission document 457, page 432, reported that tower project had encountered problems with foundations adding K2.9 million to contract price. A copy of the supporting diary note will be tendered as documents B1482 to 1485.

March 1998. There was, it seems, limited activity in respect of ANZ's facilities in March 1998. The only matters of note found included a diary noted dated 12 March 1998, commission document 457, page 434, recorded the reported results of NPF 1997. The diary note records Mr Wright's apparent continued optimism for 1998. A copy of this diary note will be tendered as document B1486, 1487.

Financial results: "It has been reported in the press that NPF recorded an unaudited NPAT of K35.1 million for 1997."

THE CHAIRMAN: What is a NPAT?

MR WARDLEY: NPAT, the Net Profit After Tax. Continue the quote: "According to Noel Wright, NPF had budgeted for a NPAT of K44 million for 1998. He believes, however, that NPF will exceed this target." On 17 March 1998, ANZ diary note found in commission document, page 437 records that the following additional shares had been received by ANZ Nominees from Wilson HTM.

[10.20 am] 6 million Highlands Pacific shares, 1,115,000 Lihir gold shares, 602,310 Oregon Minerals shares, 3,675,800 Vengold shares, 23,609,131 Cue Energy shares. A copy of the diary note dated 17 March 1998 will be tendered as document B1488.

April 1998. April and May 1998 were also inactive months where NPF's facilities with ANZ were concerned. The only matters of note are as follows. On 6 April 1998, ANZ diary note commission document 457 page 443: "Jock, NPF's annual review date is scheduled for 10 April. Audited financial statements are not, however, usually available until May each year and last year we submitted our annual review as at 30/6/98. It is therefore proposed that the annual review date for NPF be amended to say 30 June to allow for the receipt of audited financial data. Please note that if we continue to stay close to this customer on re monitoring the group's financial position on a quarterly basis with diary note advices being provided to yourself. Management accounts for the financial year end 31/12/97 reveal sustained profitability. 1997 NPBT 31.9 million; 1996 29.7 million and an improvement in members funds to K298.2 million - K208.8 million 1996. Scrip is being marked to market on a daily basis. We currently have loan cover in excess of 190 per cent, loan covenant of 150 per cent." A copy of this diary note will be tendered document B1489.

May 1998. 21 April 1998 commission document 457 pages 450 and 452 ANZ Nominees recorded the receipt of the following shares as security. 3 million Oregon shares, 26,156,500 Cue Energy shares, 6,073,071 Steamships shares, 2,976,455 Cue Energy shares.

21 May 1998 ANZ diary note commission document 457 page 457 recorded receipt of NPF's draft financial results for 31 December 1997. This review was generally positive. We note that no substantive analysis was performed. Consequently, we find no mention of the reversal of K10 million provision nor the K18.5 million Bank of Hawaii transaction and no consideration of equity accounting treatment. A breach of the current ratio covenant was also noted but this was considered technical only.

June 1998. On 15 June, 1998 according to ANZ diary note of that date which can be found in commission document 457 page 462, NPF had this time breached the loan covenant requiring NPF to maintain 150 per cent security coverage for the Australian dollar facility. The diary note records that NPF pledged the additional scrip to rectify position. These were shares pledged: Highlands Pacific 6,064,196 shares with a value of AUD\$3.8 million, 115,000 Oregon Mineral shares with a value of 294,000, 98,356 Steamships Trading shares with a value of 418,000, 183,300 Vengold shares with a value of 307,000. Total Australian dollar value 4,840,000. A copy of this diary note will be tendered as document B1490.

On 17 June 1998 commission document 457 at page 464 of ANZ diary note states that NPF had breached the 150 per cent security covenant. The diary note recorded that Mr Wright had

advised ANZ that NPF would lodge the following shares with ANZ Nominees. Shares pledged.

[10.25 am] 21 million Macmin shares, value AUD\$1,281,000. 1,812,000 Oregon Mineral shares, value 3,787,000. 837,000 Vengold shares value 1,263,000. A total of shares paid 6,332,000. A copy of this diary note will be tendered as document B1491.

Despite Mr Wright's advice to ANZ on 30 June 1998, commission document 457, page 469, ANZ diary note records that a further breach of the 150 percent covenant had occurred and that in addition the shares that Mr Wright had promised had still not been received by ANZ Nominees. The diary note recorded that the security coverage was now 135.2 percent and on review the senior credit manager Mr Frazer noted: "Please expedite the outstanding matters and follow up covenant breaches as a matter of urgency." A copy of the relevant diary note will be tendered as document B1492. On 28 July 1998, commission document 457, page 477 records a further breach of the 150 percent coverage, where at 27/07/1998 security coverage was recorded at 145.4 percent. Again Mr Wright was recorded as advising that scrip would be made available to ANZ.

Further concerns were noted by the senior credit manager in a review note addressed to Mr Jenkin: "Tait, please expedite your review with attention particularly on regular breaches of covenant, and mix of stocks pledged as security." A copy of this diary note will be tendered as document B1493. It may not have escaped the commissioners' notice that in reviewing NPF's facilities with ANZ we have not made any reference for some time to board decisions and approvals concerning the NPF's loan facilities with ANZ. The reason is simple. In the period between the 106th meeting held 5 May 1997 to a special meeting held on 16 March 1999, we can find no specific reference in the minutes on the subject of NPF's loan facilities with ANZ. The board minutes for this period can be found in commission documents 49, 50 and 51. In addition to this a review of the board papers prepared by management for this period reveals that the reports prepared also omitted to provide an update on the fund's borrowings with ANZ. Given the level of debt this was indicative of poor financial management.

At July 1998, according to NPF's management accounts, commission document 27, NPF's debt stood at approximately K117 million and which was made of ANZ K79.4 million, BSP K15.12 million, PNGBC Tower K22.19 million. Total K116.71 million. A copy of an extract - - -

THE CHAIRMAN: Is that not just a wee bit of an understatement or quite a big understatement if from 5 May 1997 to 16 March 1999, given what was happening in the arrangement with the ANZ loan facility and the difficulties now that the fund is having in meeting its commitments to it a bit of an understatement to say it is just indicative of poor financial management. It is that but it is a bit incredible, is it not?

MR WARDLEY: It certainly seems so. There seems to be no mention whatsoever in the minutes and obviously they were having board meetings on a reasonably regular basis.

THE CHAIRMAN: Yes, they certainly were. And no questions and no reporting.

MR WARDLEY: That would seem to be the inference.

[10.30 am] THE CHAIRMAN: The board was aware that there was a loan of this size or not?

MR WARDLEY: I cannot comment as to whether the board were aware of the Bank of South Pacific or PNGBC loan because I am not really involved in detail- - -

THE CHAIRMAN: Yes. No, with regard to the ANZ only.

MR WARDLEY: In the ANZ there is the issue still on foot that only certain of the facilities had been- - -

THE CHAIRMAN: Approved.

MR WARDLEY: Approved.

THE CHAIRMAN: Yes.

MR WARDLEY: Which again as we summarise, those factors will need to be highlighted.

THE CHAIRMAN: Sure. Okay, thank you.

MR WARDLEY: A copy of an extract from the finance report supporting this will be tendered as document B1500.

The failure to provide any material report to the board of trustees on the ANZ facilities and the NPF's debt position is without doubt a major weakness of management's reporting systems. To repeat what we have said earlier, it would be our view that in respect of both management and the trustees' management of the fund's debt, there are serious question marks about the discharge of their duties.

NPF management and the trustees, judging by the evidence available to this commission can be criticised in that (a) management appears to have failed in its implied duty to provide the trustees with relevant, timely and adequate information concerning NPF's debt position; establish relevant risk management procedures to mitigate borrowing risk; properly inform the trustees of developments concerning the pledging of additional share scrip where the value of assets pledged to ANZ fell below the required 150 per cent security coverage; react in a timely manner where clearly the macro-economic environment, i.e. interest rates, exchange rates and resource sector were adversely impacting upon the fund; and (b) the trustees appeared to have failed in its role in that they failed to inquire from management as to the status of the ANZ facilities; properly understand the risks inherent to the fund's investment approach; consider whether management was appropriately qualified and competent in the field of investment and provident fund issues; react to the clear warning signals in late 1997 and early 1998 where interest rates, exchange rates and share market prices all adversely impacted upon the fund.

It would seem to us based on the available evidence, management and the trustees just did not realise the potential risks associated with the fund's debt strategy. If they did, it would appear they simply did not have the skills and experience to react in an appropriate manner. They simply did nothing. This was a severe case of management paralysis in a crisis. Copies of relevant extracts from the board papers can be found in commission documents 20, 25, 26, 27, 28 and 29. And these will be tendered as documents B1494 to 1503.

August 1998 can be seen as the turning point in the relationship between ANZ and NPF. And also by this point it is clear the fund was already showing signs of financial stress as evidenced in a number of ANZ diary notes and correspondence sent to NPF. We will now read through a sample of this. These can be found in commission document 457 and 459 and will be tendered as documents B1504 and 1508.

A letter dated 31 August 1998 sent to Mr Wright by Mr Jenkin reads as follows: "Dear Noel, re foreign currency loan facility. As you are aware, NPF is in breach of the facility, specifically the events of default set out in clause 9 of the FCL and accordingly under clause 10 of the FCL the ANZ is entitled to: (1) cancel facility; (2) require immediate repayment of all monies outstanding under the facility; and (3) exercise any power, rights and privileges conferred by law by this agreement, i.e. the FCL, the security or any other collateral documents or securities.

As discussed at this morning's meeting at Defence Haus attended by yourself, David Well, David Moore and myself, the bank requests that NPF remedies the breach within the next 48 hours.

[10.38 am] We note that you have undertaken on behalf of NPF to lodge and assign to the bank sufficient Steamships Trading Company scrip as security to remedy the breach within the 48 hour time frame. In light of recent negative stock market trends, we request further security as a minimum that NPF assigns to the bank in excess of 3 million additional Steamships Trading scrip. The bank also requests that NPF provide an assignment over the existing shares held as scrip, ie Cue Energy, Vengold, Steamships Trading, Orogen Minerals, Highlands Pacific and Macmin. Such assignment to be prepared by the banks' lawyers. Furthermore, the bank requires that NPF provide the below mentioned information within a period of three weeks, ie by 21 September 1998:

(1) Latest management accounts, ie 31 July 1998 or later, including balance sheet, profit and loss statement, investments breakdown, IBD schedule and negative pledge compliance certificate together with an explanation of significant movements in income assets and liabilities.

(2) Detailed integrated budget, ie balance sheet, profit and loss statement and cashflow forecast for the ensuing 12 months assuming: (a) that the foreign currency bond proceeds; and (b) that the foreign currency bond does not proceed. The budgets should be accompanied by detailed

assumptions on all major line items.

(3) A summary of NPF's key investment and other strategies for the next 12 months and beyond. Has NPF updated its 5 year plan?

(4) A detailed update on the foreign currency bond including NPF's rationale for proceeding with the bond particularly in light of: (a) currency stability; (b) high interest rates; and (c) declining commodity and share prices. How does NPF propose to repay the Australian dollar commitments? What strategies does NPF have in place to cope with adverse exchange rate interest rate, share price movements?

(5) A detailed update on the NPF Tower project including: (a) cost to date, cost to complete; (b) details of any cost overruns; (c) details of pre-leases, if applicable.

(6) A detailed update on the Southern Highlands Provincial Government Road project. How does NPF propose to fund this project? A listing of NPF's unencumbered assets. Details of current finance facilities with other lenders, ie outstandings, limits, security pledged, repayment terms.

(9) A brief resume of the new managing director and the current board members of NPF.

(10) A copy of the final audited accounts for the financial year ended 31 December 1998, if available."

COMMISSIONER SIAGURU: I just wonder the request for resumes of the managing director and board members, I think that is an issue that has been discussed at the seminar or at least an issue that we are looking into. It is interesting that has come up so early.

MR WARDLEY: As to the relevant experience within the board of trustees.

COMMISSIONER SIAGURU: Yes. Thank you.

MR WARDLEY: Continuing with the quote: "Please note that pending receipt of the above mentioned data and completion of the bank's full review process, NPF's facility will be capped at the current level of exposure in AUD \$53,760,533." A copy of this letter found in commission document 57 - I am sorry, there is a typographical error. It has got "57H". Does somebody know what a "H" is on the numeric typewriter?

THE CHAIRMAN: What problem?

MR WARDLEY: It is obviously a lower case and upper case thing we have got on 50. So it should be 57; I doubt if it is 57H.

COMMISSIONER SIAGURU: Yes, instead of doing their numbering, they hit the letter without pressing the button to provide- - -

MR WARDLEY: I think so. I will check on that number and refer back. So a copy of this letter found in the commission documents shows that Mr Wright and Mr Leahy signed the letter on behalf of NPF. As far as we can determine, this breach, and the many others referred to previously, were never reported to the board, according to the board minutes: commission document 50.

THE CHAIRMAN: I am sorry, it says that they signed the letter. The letter was to them. What does it mean that they signed the letter from the bank to Noel Wright. I wonder if I have got the wrong letter.

[10.40 am] Do they have to sign for a receipt of the document?

MR WARDLEY: They very often do so, yes.

THE CHAIRMAN: Yes.

MR WARDLEY: Yes, they very often do so. I will just have to confirm if that is what we are talking about, that is the receipt of the letter rather than- - -

COMMISSIONER SIAGURU: I think it was Mr Jenkins from ANZ who wrote to Mr Wright.

MR WARDLEY: Who wrote the letter, yes.

THE CHAIRMAN: Sorry, I just want to confirm the receipt of this letter.

MR WARDLEY: I think that is what we are trying to allude to. Yes, I will confirm if that is so. A letter dated 1 September 1998 sent by ANZ to Mr Wright records the decline in NPF security and requests NPF to remedy the breach.

"Dear Noel,

Re: Foreign Currency Loan Facility.

Our letter dated 31 August 1998 refers. We acknowledge receiving a copy of your letter to Ms Sue Gye. Wilson HTM dated 1 September 1998 and we confirm that ANZ Nominees have today received 4 million Steamships Trading Company scrip. Subsequent to our meeting yesterday, however, there have been further declines in the value of scrip pledged to the bank as security. A copy of our latest spread sheet is attached which reveals that NPF remains in breach of the facility.

As discussed at our meeting on 31 August 1998, the bank requests that NPF remedies the breach within the next 48 hours. In light of the above, the bank requests further security as a minimum that NPF assigns to the bank 4 million additional Orogen scrip and or 2 million Collins and Leahy scrip. Such assignment to be prepared by the bank's lawyers.

Please also arrange for a copy of our letter dated 31 August 1998 to be signed by yourself and the company secretary and returned to the office within the next 48 hours.

Should you wish to discuss any aspect of this letter, please do not hesitate to contact me on telephone number" deleted.

So, obviously that is answering the question which has been raised.

THE CHAIRMAN: You see, the situation they got themselves into now is that they have been told by the bank to sign this within 48 hours which is a further transfer of securities and what chance have they got of getting board approval for doing that in that time and what did they do; we will no doubt see in a moment.

MR WARDLEY: Yes, but the inference is that the board was not being kept in the picture at all at this stage. A series of internal ANZ e-mails also record the breach of the security covenants: "Share coverage as at 24 August 1998 at 145.2 per cent includes outstanding shares yet to be received, without these share coverage comes to 136.2 per cent." "I have spoken to ANZ Nominee this morning and am now awaiting confirmation that said shares are still outstanding. Upon confirmation, a default notice will be issued to NPF requesting additional shares or a cash deposit sufficient to bring security coverage to 150 per cent as per facility arrangements. I have discussed the possibility of the bank realising shares held to bring the security coverage into line with Martin McEniery of C and L and he will be reviewing the facility letter today and reverting with his advice. Noted: Thanks David. Please let me know immediately what the company proposes to do about the situation. Noel Wright should be in no doubt that we will not let the matter drift and expect covenants to be brought to order in the very short term. Keep me posted daily with regards to scrip value, et cetera. One other thing, I am conscious of the increasing per cent of Vengold scrip which we hold or are offered. We need to determine how much of this paper we are prepared to tolerate. In my mind, this is not blue chip paper."

[10.45 am] "Ross, we have been carrying this breach of covenant on an excess basis. In recent months the breaches have been more frequent and on this particular occasion the company has been tardy bringing the matter to order. David Bell and I have discussed the possibility of reducing NPF's limits permanently. We are conscious of a weakening Aussie bourse, weakening economic indicators in PNG and our belief that the NPF balance sheet is carrying much more debt today than the last time we saw it. Tait Jenkin, account controller is at Flowerdale this week and I shall be precipitating discussions with him along these lines early next week."

"David Moore, I fielded that a call from Noel Wright yesterday and also I am in receipt of his letter addressed to yourself dated 25/08/98 setting out the current circumstances. Noel has informed me that the documentation relative to the US Bond will be executed this Friday, 28/08/1998

which will then enable the funds to be brought into PNG, he says, by mid September. On that basis I have agreed to stay any action on our part until Monday 31 August 1998 when it is expected you will have unequivocal evidence of the execution of the necessary documentation to which I refer above. We can then discuss our next move.

The intention is for sufficient cash to be placed on deposit with ANZ to correct covenant shortfalls. If by 31/08/98 the evidence is not produced Noel is aware we will move to rectify the situation by selling down sufficient script to satisfy our requirements. Noel is under no illusion that the bank has been patient and tolerant, but is now a little nervous with a weakening ASX and poor commodity prices affecting the scrip value of the companies providing our security. I also alluded to the additional debt which NPF must be carrying relative to the building in POM and the fact that interest rates were at record high levels. This is also contributing to our nervousness. Please respond to the Carter Newell's request, re security documentation and ensure you are all in a position to move the moment we feel it is necessary. In terms of recent events there has been concern expressed by the credit line as to the existing position and indeed the short term future. I share this concern. I believe we need, as a priority, to review our current position relative to the safety of our exposure and to do so will mean critically examining various aspects including but not necessarily limited to: Latest financial statements for or at the least management accounts to 31/07/98 which are to reflect the real value of assets, not simply cost values, that is balance sheet using real values, P and L et cetera; current cash position and future cash generation. What assets are held unencumbered including shares? What is the cash source which will be required to fund the loan to SPHG for road construction? What was the company's response to increased interest rates as a result of CRR, i.e 10 percent extra rate? What is the position relative to the POM building, in particular increased costs, devaluation of Kina, et cetera? What is our margin over SIBOR, should this be increased? Can we reduce limits to outstanding? Apart from anything else, the unused portion is costing an arm and a leg under the AOP. How quarantined are surplus funds, i.e from being syphoned to government coffers? I sincerely hope our concerns are unwarranted but these latest events in not being able to comply with security covenant and the time taken to rectify, not to mention the amount of management time necessary on this file, indicated that Noel Wright or the board are finding things difficult. Even if the much mooted bond funds arrive early next week, whilst deriving some comfort, we need to be able to approach the future with more certainty on this exposure.

[10.50 am] You really need to get on top of this quickly and I suggest a meeting early next week with Tait, David and myself is time critical. David, please organise. I am okay Monday and Tuesday morning."

THE CHAIRMAN: It becomes clearer why Mr Wright was so dogged in holding onto the chance of that bond, even though its chance was becoming really quite untenable. He must have been absolutely desperate to get that bond money in.

MR WARDLEY: To solve another problem.

THE CHAIRMAN: To solve this problem which had not yet been disclosed to the board.

MR WARDLEY: Correct, yes.

THE CHAIRMAN: Nor had the bond, or unless the bond - the board was aware of the bond to some extent.

MR WARDLEY: It was aware of its general terms of the bond, but obviously- - -

THE CHAIRMAN: Yes, that there was an attempt.

MR WARDLEY: It certainly would not have been appreciative of what was culminating in- - -

THE CHAIRMAN: Where the bond money was going to end up.

MR WARDLEY: Yes. And obviously now instead of going to use it for his original concept - if received, it would have been used to alleviate this problem.

As can be seen, ANZ's reaction was swift, and a plan of action was quickly developed to undertake a detailed review of NPF's financial position and also to flag this account as an account requiring careful attention. Copies of these ANZ diary notes found in commission document 457 will be tendered as document B1504 to 1508.

In response to the breaches in the covenants, ANZ reviewed its strategy and then sought a meeting with NPF to explain ANZ's stance on the issue. ANZ's position was recorded in a diary note dated 31 August 1998. This recorded the outcome of the meeting with NPF and two internal meetings as follows.

"Purpose of diary note. To document the outcome of three meetings held today at Defence Haus called in response to the current breach of the FCL facility and NPF's failure to remedy the breach within an acceptable period of time. Diary notes dated 14/8/98 and 27/98 refer. Meeting, (1) meeting held at 8.30 am and attended by David Bell, deputy managing director and head of business banking; Jock Frazer, senior credit manager; Tait Jenkin, manager business banking; and David Moore, business banking analyst. Objective of the meeting was to achieve a common strategy prior to meeting with the customer scheduled for later in the day.

48 hours strategy. Call for breach of FCL facility to be remedied within 48 hours by either cash cover, lodgement of additional scrip or reduction of facility. Failure to remedy breach to be followed by sale of scrip. To be discussed further. Reduce credit limit to the current level of exposure, namely AUD\$53,760,533 pending completion of our full review.

3 weeks strategy. Request detailed information to enable full and proper assessment of NPF's position.

1. Latest management accounts, i.e. 31/7/98 or later, including balance sheet, profit and loss statement, investments break down, IBD schedule, and negative pledge compliance certificate together with an explanation of significant movements in income, assets and liabilities;
2. Detailed integrated budget, i.e. balance sheet, profit and loss statement and cash flow forecast for the ensuing 12 months assuming; (a) that the foreign currency bond proceeds; and (b) that the foreign currency bond does not proceed. The budgets should be accompanied by detailed assumptions on all major line items;
3. A summary of NPF's key investment and other strategies for the next 12 months and beyond as NPF updated its 5 year plan;
4. A detailed update on the foreign currency bond including NPF's rationale for proceeding with the bond, particularly in light of (a) currency instability; (b) high interest rates; and (c) declining commodity and share prices. How does NPF propose to repay the Australian dollar commitments? What strategies does NPF have in place to cope with adverse exchange rate, interest rate, share price movements?;
5. A detailed update on the NPF Tower Project including (a) cost to date, cost to complete; (b) details of any cost over-runs; (c) details of pre-leases if applicable;
6. A detailed update on the Southern Highlands Provincial Government road project. How does NPF propose to fund this project?
7. A listing of NPF's unencumbered assets;
8. Details of current finance facilities with other lenders, i.e. outstanding limits, security pledge, repayment terms;
9. A brief resume of the new managing director and the current board members of NPF;
10. A copy of the final audit accounts for the financial year ended 31/12/97 if available.

Meeting 2. Meeting held at 11 am and attended by Noel Wright, deputy managing director NPF; David Bell, deputy managing director and head of business banking; Tait Jenkin, manager business banking; and David Moore, business banking analyst.

[10.55 am] DB: Explained to Noel Wright the bank's concerns generally and informed him in no uncertain terms that the bank wants the security cover breach to be remedied within the next 48 hours failing which the bank would move to realise on its securities. NW undertook on behalf of NPF to pledge sufficient Steamships Trading shares as security to remedy the security breach. DB agreed to accept Steamships Trading shares to remedy the breach but stated that the bank wants a buffer to protect against any further negative stock market movement. NW

acknowledged request for buffer. NW indicated that the NPF board are still keen to conclude the foreign currency bond transaction and that NPF would later seek the release of the Steamships Trading shares in exchange for Australian Dollar cash deposit. DB stated that the bank would not release the Steamships Trading shares if this resulted in ANZ (PNG) being exposed for a period pending lodgement of Australian Dollar cash deposit. In this regard NPF should seek legal opinion with a view to achieving a simultaneous exchange of scrip for Australian Dollar cash deposit. NW acknowledged the bank's position and undertook to seek legal opinion. DB, stated that it is the bank's strong preference that NPF reduce debt. NW all right, we will reduce debt then. TJ stated the type of information that the bank requires within the next three weeks to enable the bank to undertake its full review of NPF, refer points above. NW undertook to comply with the bank's request for information within the time frame specified. Other information imparted by NW; NPF tower, fixed price contract has safeguarded NPF against cost overruns. Membership contributions, NPF are netting K1 million per month. Southern Highlands Province road projects, NPF have agreed to fund approximately K6.5 million but to date have not released any funds.

Meetings 3, attended by David Bell deputy managing director and head of business banking, Jock Frazer senior credit manager, Tait Jenkin manager business banking and David Moore business banking analyst. Agreed that the bank would seek lodgement of additional Steamships Trading shares sufficient to provide a 10 percent buffer above our existing 150 percent security cover covenant within 48 hours. If further top up of security becomes necessary, bank to seek lodgement of Oregon scrip. Agreed that the facility limit would be reduced immediately to current exposure. Account controller to forward letter to NPF outlining the bank's position. FCL's maturing to be rolled on 30 days basis pending completion of full review." A copy of the diary note in question can be found in commission document 457 and will be tendered as document B1509, 1511.

THE CHAIRMAN: We might just take a short break now in this episode.

MR WARDLEY: Certainly.

THE CHAIRMAN: So, we will come back at five past.

MR WARDLEY: Certainly.

THE CHAIRMAN: Sorry, five past 11. Thank you.

### **SHORT ADJOURNMENT**

[11.10 am] THE CHAIRMAN: Yes, Mr Wardley?

MR WARDLEY: Thank you. Following on from ANZ's meeting with Mr Wright, we find that on 3 September, 1998 an ANZ e-mail commission document 457 page 500 indicates that ANZ had also met with the new Managing Director, Mr Henry Fabila. The diary note records a positive outcome to this meeting from ANZ's perspective.

"From Bell David PNG to Breheny Justin Singapore. Subject: FW NPF. Date, Friday 4 September 1998, 9.57 am.

Justin, yesterday Tait Jenkin and I met with the new Managing Director, Henry Fabila who is an impressive national. He will forward his CV to us but in brief worked for the government bank, PNGBC 26 years and became the managing director in his last 18 months. He has been the Governor of the NCD similar to say mayor of a city in Australia, but was forced to leave due to death threats against himself, family and employees and in fact was badly beaten at one stage. This would all indicate, he was trying to enforce discipline and eradicate corruption, et cetera.

Prime Minister Bill Skate sought his CV and Mr Fabila's response was: "Forget it, I will not work for the government." Very admirable indeed. However, due to some form of political pressure, he was offered the top job at NPF which he says he initially had misgivings about because of the much mooted desire of the government to get its hands on any cash floating around in various institutions, et cetera and he did not want to be a party to this.

However, having completed his own due diligence, he was satisfied that the NPF which is a

private sector superannuation fund constitution can effectively quarantine surplus cash because its board is a tri-partite arrangement whereby nine board members are represented by three each from employers/employees and the government and that NPF whilst perhaps having not been overly cautious in some of its investments and highly geared is a sound institution and can once again fairly quickly because the cash coin it recently was, eg it has pledged K80 million cash to Bank of Hawaii for a K80 million loan to fund government infrastructure projects, recently completed K59 million freeway, for instance. As this loan is paid down, deposit funds will be released.

[11.13 am] Mr Fabila had not been aware of the security covenant default and stated he has not been kept fully informed by Deputy MD Noel Wright. This has changed and he will insist on a weekly detailed update on events and current funds position. He has requested that any matters relative to banking arrangements, be directed through him. He stressed that he fully understands our position and NPF will provide its fullest cooperation with the bank in an open manner.

In summary, I was impressed with his financial intellect and the fact that he is intimate with all the machinations after only two months in the chair. The proof is still in the pudding though, and we will be watching events very closely." A copy of email dated 4 September 1998, will be tendered as document 1512.

We do not know what prompted Mr Fabila to meet with the bank in September 1998, but it should be noted that Mr Fabila had been appointed 5 May 1998 and it would seem that based on the afore-mentioned diary note, that this was Mr Fabila's first meeting with the bank. Mr Fabila had in fact been in his position for some five months, not the two months noted in the ANZ e-mail.

With recent adverse developments as a backdrop, ANZ manager business banking, Mr Jenkin, prepared the annual review credit memorandum for NPF's facilities and which will be used to assess the continued extension of facilities to NPF. As one can imagine, this credit memorandum was extensive. A copy of this credit memorandum can be found in commission document 459 and will be tendered documents B1513 to 1555. Included in the credit memorandum, was a schedule of the breaches of security covenants and which were listed in the credit memorandum as numbering 10 between 6 June 1998 to 3 September 1998.

THE CHAIRMAN: It is a bit surprising that the bank that has been so worried, can have not known who the managing director was.

MR WARDLEY: It does seem for a five month period because I am sure it would have been in the daily press of the appointment and- - -

COMMISSIONER SIAGURU: Or even insisted that he be there at the meetings that they had with Mr Wright.

MR WARDLEY: My understanding was that the NPF's account with ANZ Bank was one of their largest accounts. It does seem a little bit strange that five months before- - -

THE CHAIRMAN: And one which they had during that period, had started to become really worried about. There had already been monitoring on a daily basis for sometime.

MR WARDLEY: Yes, yes.

THE CHAIRMAN: Yes, thank you.

MR WARDLEY: The salient matters of note included in the credit memorandum were: "Account relationship strategy. Account strategy: maintain. Comments: Our short term strategy is to obtain more detailed information on the fund's current position and future strategy direction, and it is our intention to undertake a further review on receipt of same. In the meantime, NPF's facility has been kept at the current level of exposure; namely, AUD \$53,761,000."

[11.15 am] ANZ whilst carefully reviewing its position was also, however, keen to maintain this account with NPF.

Under the heading of financial analysis, the following conclusions were reached: "Risk of default is considered low given the fund's strong cash flow and sound balance sheet position. Fall back position is considered satisfactory given the minimum security cover covenants on the foreign

currency loan - non trade and fully drawn advance of 150 per cent and 190 per cent respectively. Any future breaches of security covenants will be brought to the personal attention of the fund's managing director.

Recommendation. The fund's facilities are to remain capped at the current level of exposure namely, AUD\$53.76 million pending receipt of detailed information requested on the fund's current position, strategic, direction and completion of our interim review on or before 31/10/98.

Australian Dollar based securities. 52,742 - no I am sorry, that is incorrect. 52,742 Cue Energy shares AUD\$2,110, 21,412 Vengold shares AUD\$30,687, 7,048 Steamships shares AUD\$35,242, 4,303 Oregon shares AUD\$8,695.

THE CHAIRMAN: Do you think that Australian dollar listing for the 52,742 Cue Energy is correct?

MR WARDLEY: I think these are, there are three extra noughts to be included on this because if we look at the total Australian Dollars security over the page, it is talking about Australian Dollars 100,507 so these have to be in - not thousands, there have to be an extra three noughts on the equation from the - that is how the internal memo is worded. But there just has to be extra- - -

THE CHAIRMAN: They just did not like to take up space with the noughts.

MR WARDLEY: No. And 68,064,000 Highlands Pacific shares Australian Dollar value 22.461 million and 21,876,000 Macmin shares value of AUD\$1,313,000. Total Australian dollar security AUD\$100,507,000. EU at 65 per cent, 65,330,000 - 65.330 million - margin 11,569,000.

Share cover. Australian dollar share cover to Australian dollar liability noted at 187 per cent in terms of existing security arrangements Australian dollars share cover to secure Australian dollar borrowings must exceed 150 per cent.

Account performance. All interest and fee commitments have been met in terms of arrangements. Operating accounts are conducted at the PNGBC.

[11.18 am] Continue with the quote: "Summary /other relevant remarks. Weaknesses, risks. 1997 profit on sale of government loan of 18.5 million is considered to be a one off occurrence. Investment portfolio is heavily weighted towards equities, 60 percent. The value of the fund's PNG resource equities have fallen significantly in 1998 which will no doubt adverse impact on the fund's profitability for the year. Note best, equities are marked to market by the fund on a monthly basis. Strengths. The fund continues to enjoy strong and sustainable cash flows through its members contributions and investment income. Strong balance sheet position is evident. As at 31/03/98 83.7 percent of total assets K347 million were held in liquid form such as term deposits and quoted investments including investments in associates. Depreciation of the PNG Kina, Australian Dollar exchange rate during 1998 is likely to partially offset the decline in the value of PNG resource stocks. NPF Tower project will help to diversify the overall investment portfolio.

Summary: Probability of default is assessed as low. Customer's integrity and willingness to repay is not doubted. Re-finance feasibility, other ways out. It is considered that re-finance would be achievable given the fund's strong cash flow, history of profitability, sound balance sheet structure and close association with the Papua New Guinea Banking Corporation."

We note that in respect of the 18.5 million profit on sale of government loan stock, otherwise referred to as the Bank of Hawaii transaction, that clearly ANZ did not analyse this transaction because as we have described in an earlier hearing, the full recognition of this 18.5 million profit in 1997 was incorrect and contrary to international accounting standards. We note also that the credit memorandum did not consider the impact on the 1997 results of a reversal of K10 million provision created in 1996 and therefore failed to identify the extent of the drop in revenue and profitability in 1997. In other words, the 1997 results were clearly distorted by these two transactions. In the credit memorandum it was reported that unaudited profits were 39.5 million. If the ANZ had adjusted the results for these two transactions they would have seen that unaudited profits were only K11 million. ANZ's conclusions concerning profitability may have been different. Also included in the credit memorandum was a risk assessment of NPF. This clearly shows that ANZ had identified the major risks impacting on NPF. The credit memorandum reviewed in detail the fund's major investments. Given the significance of these, we shall read out this section of the credit memorandum: "Key risks and mitigants. Key risks. Influence of Minister for Treasury and Planning on the fund's activities. Mitigants; NPF's strategy, role and

philosophy is controlled by the board of trustees which comprises a tripartite of nine individuals representing the PNG government employers and employees. The tripartite nature of the board of trustees means that the fund is not a vehicle or tool of political interference and that employees/employers have a significant say in the role and investment strategies of the fund.

[11.25 am] Key risks. Investment portfolio heavily weighted towards equities. Mitigants: NPF Tower Project will result in an increase in the fund's property portfolio of some K47 to K50 million which will help to diversify the overall investment portfolio.

Key risks. Quality of scrip. Mitigants: 75 per cent of scrip held is considered to be medium to good quality. The fund have 8.1 Collins and Leahy Holdings shares, current market value AUD\$40.5 million, and 4 million Orogen Minerals shares, current market value AUD\$7.9 million, which could be pledged as additional security should Highlands Pacific shares continue to lose value.

Key risks. Exposure to interest rate movement. Mitigants: The fund continues to generate strong cash flow from members' contributions and investments sufficient to cover any adverse interest rate movement.

Key risks. Exposure to exchange rate share price movement. Mitigants: Scrip is being marked to market on a regular basis to monitor share price movement. Negative pledge covenants protect against adverse movement in both exchange rates and share prices.

Key risks. Risks of early withdrawal of funds by members. Mitigants: There is large penalty of forfeiture for members who are withdrawing earlier than they should. The board has recently introduced a reward scheme to act as an incentive for members to keep their savings invested with the fund.

Quality of scrip analysis. Company name, Orogen Minerals. Comment: good quality stock, diversified resource company with interests in Kutubu and Gobe oil fields, Porgera, Misima and Lihir mines. Recently announced the sale of a 6.5 per cent interest in Lihir Gold Mine to Vengold realising a profit of K101.6 million. Orogen retains 0.9 per cent interest in Lihir. Orogen has an option agreement with the State of Papua New Guinea which affords the company the right but not the obligation to acquire up to 20.5 per cent and 25 per cent interest in major new petroleum and mineral projects undertaken in PNG respectively. 1997 NPAT of K49.56 million first full year. Company enjoys broad institutional support with an estimated 50 institutions being significant shareholders.

Bank places medium reliance on the stock with market value as at 18/9/98 of AUD\$8.7 million. Company name, Steamships Trading Company. Comment: good quality stock, diverse, non-resource company. Majority owned and controlled by John Swire and Sons, UK based entity. The company successfully defended takeover bid from NPF in 1995.

[11:29 am] NPF has a 20.66 per cent interest in Steamships Trading Co. Minimal trading in stock given limited shareholder base. Consider however that there would be ready and willing buyers for the stock. Bank places significant reliance on this stock, i.e. market value of AUD\$35.2 million as at 18/9/98. Account is controlled by senior corporate banking manager, PNG, and is currently risk graded 4D.

Company name: Vengold. Comment: Medium to good quality stock. Canadian registered company. Vengold's principal asset is a 19 per cent stake in the Lihir Gold mine. Vengold is now the largest single shareholder in the mine. The mine has 14.2 million ounces of proved and probable reserve. The mine started production last year ahead of its construction schedule and within 10 per cent of its original budget. It earned a profit of nearly AUD\$12 million in its first quarter of operation and is planning to produce over 600,000 ounces of gold this year. Average gold revenue obtained in the first quarter of 1998 was USD\$319 per ounce and current hedging programs will ensure an average price of USD\$ 350 per ounce for the remainder of the year. Total costs for the first quarter of 1998 were USD\$918 per ounce. NPF has 15 percent interest in Vengold. Stock is expected to provide healthy returns to shareholders. Stock is regularly traded on the Canadian stock exchange. The bank places significance reliance on the stock with market value as at 18/9/98 of AUD\$30.7 million.

Company name: Highlands Pacific Limited. Comment: Poor performing and speculative stock. Resource company with interests in the Ramu Nickel Cobalt Mine and the Frieda River Copper Mine. Feasibility study on Ramu is not expected until the end of the year. Feasibility study on

Frieda is not expected until 31/12/00. Cypress Amax Minerals Co is to acquire 75 per cent of Highlands, 86 per cent of the Frieda River project by becoming manager of the joint venture project through funding Highlands Pacific's share of costs of completing the feasibility study by 31/12/00. Value of stock has crashed from AUD\$ 1 at issue last year to current market value of AUD\$0.33 as at 18/9/98 due mainly to the fall in commodity prices. NPF has a 32.412 percent interest in Highlands Pacific. The investment has not provided any return to shareholders to date and is unlikely to do so in the short to medium term. NPF board however has a long term view on this stock. The bank places significant reliance on this stock with market value as at 18/9/98 of AUD\$ 22.5 million. The Highlands Pacific account is controlled by the senior corporate banking manager and is currently risk grade 6G.

Company name: Macmin. Comment: Poor performing and highly speculative stock. Gold, silver and base metals exploration. Past 3 years have not produced any return to shareholders nor do any returns appear likely in the short to medium term.

[11.34 am] Since lodgements of scrip, 25/6/98, the share value has ranged between 5 cents and 7 Australian cents. NPF has a 19.435 per cent interest in the company. Bank faces nominal reliance on the stock, i.e. market value of AUD\$1.3 million as at 18 September '98.

Company name, Cue Energy Resources. Comment: medium to good quality stock. New Zealand registered company involved in oil and gas exploration and development. The company has a 2.44 per cent equity in the Southeast Gobe oil field, PNG. Approved and probable reserves of 63 million barrels or approximately 1.54 million barrels net to Cue Energy. First oil export from the project commenced on 29/3/98. NPF has a 10.094 per cent interest in Cue Energy. NPF board are very satisfied with this investment and expect satisfactory returns on shareholders' funds. Bank places nominal reliance on the stock, i.e. market value of AUD\$2.1 million as at 18/9/98. NB, all scrip is being marked to market on a daily basis."

We can see it from the risk analysis performed by ANZ that only two investments were classified as good quality stocks. We also note that all but one of the major stocks held as security were resource sector stocks. There was therefore limited diversification of risk.

The normal procedures for the approval of the periodic credit memorandum was that the manager responsible for the account prepared the credit memorandum and there was then a formal review procedure requiring the approval of the senior credit manager and head of business banking in Papua New Guinea. It would also appear that in the case of NPF, ANZ PNG also sought the approval of international credit operations and the general manager responsible for the Pacific region.

[11.36 am] Therefore subsequent to Mr Jenkin preparing the credit memorandum of September 1998, it was reviewed by Mr Frazer as senior credit memorandum.

An email found in commission document 457 on 27 September 1998 sent by Mr Frazer to Mr Jenkin outlines the senior credit manager's review of the credit memorandum. A copy of this email will be tendered as document B1557. The email highlighted Mr Frazer's concerns on a number of issues. "Tait, at this point I will not forward your CM to Melbourne, Singapore, preferring instead to wait until the company has provided you with the additional information you have sought from Noel Wright and Henry Fabila. Whilst the CM is useful, it concentrates on issues which have been overcome by events during 1998. It is important for us to concentrate now on the contemporary issues which have made us nervous over the last two months, and to also determine a firm strategy appropriate for 1999 and beyond. To that end, I would like you to prepare an information paper based upon what you are to receive from the company which will effectively become an addendum to the ARCM. In the interim, please give some thought to the following issues which are exercising my mind. I would appreciate it if you then give me a call to discuss our strategy for going forward.

If the bond issue is ultimately successful I want the debt reduced to AUD\$25 million with existing covenants remaining in effect. There would be no capacity to increase limits in the foreseeable future or until we better understand the critical risks to which the company has become exposed. What deadline should we impose on the company before considering the bond will not happen.

What then do we do if the bond is not successful. I am nervous about the Aussie bourse and its potential for further downward correction. Therefore, I want some thought given to the percentage make up of our scrip security.

The Highlands Pacific paper is approaching junk status as the value of the Ramu Project is compromised by increasingly valueless commodities. Our reliance on HP is too high. Obviously if we go to AUD\$25 million we can hand some paper back, but I do not want to be left with just rubbish, speculative paper. I have presumed and you might confirm that Vengold scrip is all ASX paper, not Canadian. The inference being that our securities probably do not extend to Canada.

We need Martin McEniery to review our security documentation relative to the introduction of the new Companies Act.

[11.39 am] And to confirm all is in order. Ultimately, we will need to issue a new facility letter which should also be prepared by the solicitors. The financial data omits the Bank of Hawaii facility which I was told was PNG Kina 80 million and fully cash collateralised. Can you probe these? Can you also elaborate on sale of K54 million loan, re Poreporena highway? Sale of 1.5 million Bank Papua New Guinea stocks. Prospects of collecting 23.8 million outstanding POSF government debtors. Variation, profit contribution from associated companies. Page 4, variously K7.2 and 9.5. Situation re WIP on The Tower project. So far as prudential considerations are concerned, I would like the clause rewritten to exclude reference to recent guidelines. These are now five years old. And, to include the current BPNG proposals to, in fact, vary the guidelines from 50 percent to 25 percent, yet to promulgated and subject to debate between the Central Bank and the Commercial Bankers' Association. The risk grade based upon the data in front of us is probably still 4B but I believe there are significant management issues and cash flow issues which have cut the grading under pressure. Without CART it is difficult but you and I need to throw that one around. If we decide this is worse than 4, your CM to CAC in Melbourne and the waters will then be further muddied. To precis: we need a strategy. We need to understand the business and what is happening today, not six months ago. We need to be firm in our resolve going forward. The asset is significant but in this case, as in every case, prudence is a priority. We need to ensure our documentation is perfect. Please gather your thoughts and call me this week. At this stage, I will be expecting your following information paper to be completed by the end of the first week in October. Cheers, Jock."

THE CHAIRMAN: "Cheers," seems an inappropriate concluding comment.

MR WARDLEY: Yes. Yes.

THE CHAIRMAN: No consideration appears at that stage to be given to whether NPF has a power to borrow. This is occurring after ANZ previously has previously had advice it had no power to borrow, is it not?

MR WARDLEY: At this stage, ANZ had received advice from Carter Newell Lawyers on two occasions that NPF did have a - - -

THE CHAIRMAN: Was okay. Had not had the Gaden's advice yet.

MR WARDLEY: Correct. It is not too far away in the time scale.

THE CHAIRMAN: All right, thank you. It has to have been a bit of a shock when it arrived then.

MR WARDLEY: The credit memorandum was then submitted to ICO for approval on 20 October 1998. Mr Frazer's memorandum to International Credit Operations highlighted ANZ's uneasiness with the security currently available for the facility. A copy of Mr Frazer's memorandum is found in commission document 457 and a copy will be tendered as B1558, 1559.

[11.43 am] "At this point we await the finalisation of the Fund's attempt to raise funds via Australian dollar bond issue in USA - in the circumstances, we are prepared to extend our deadline, for this to occur, until 30 October 1998 to coincide with the approval provided by the Bank of PNG for exchange control.

In the meantime we have discussed the options available to us in the event the bond proceeds or in the event it does not proceed - see Scenarios A to D in the information memorandum.

Our recommendation to you is for either of Scenario A or B to be approved depending upon the fate of the bond.

Scenario A replaces unfavourable Highlands Pacific Limited scrip with the more valuable paper of Collins and Leahy Group which is an excellent outcome - we also retain Steamships Limited

scrip which contributes to a more satisfactory spread of securities.

Scenario B also replaces unfavourable Highlands Pacific scrip with Collins and Leahy Paper although in less quantity and releases the Steamships paper replaced by Australian dollar term deposit.

In both cases existing Australian dollar limit is retained at 53.8 million and our earlier commitment to total facilities of AUD\$80 million is withdrawn.

As part of this recommendation, we are also taking the opportunity to lift our existing covenant from 150 per cent scrip cover to 160 per cent scrip cover marked to market with appropriate clawback clauses attaching.

The account controller has provided an excellent snap shot of the fund's situation at this point in time. We lack only cash flow forecasts for the next 12 months available late October following presentation to the board and a precis of the new members of the board. Notwithstanding there have been changes to the make up of the board members, representation remains three government, three employers, three employees.

All things considered, we are comfortable going forward and you are asked to provide your dual approval together with Mr Breheny. CCR 4B continues to be an accurate reflection of the risk despite our inability to provide a CART analysis."

By 7 October, the Senior Manager International Credit had reviewed the credit memorandum and evidence of his approval was faxed to ANZ in PNG. A copy of the approval will be found in commission document 457 and will be tendered as documents B1560 to 1561.

[11.46 am] An internal ANZ email also records the review of ANZ's international credit and the strongly held view that the bank should maintain its strong stance in respect of NPF's breaches of the loan covenants. "Justin, I have advised Jock Frazer separately that Mike Dempsey has had a good look at the file and is aware of the current situation. I have also advised that the subject CM will be handled here. The material forwarded is self explanatory and informative. All involved with this are well on top of the situation and Jock Frazer has been in constant contact with me during the recent breaches of the security covenant. He is well aware of my views on the arrangements. They must be complied with and the bank must not allow itself to be drawn into tolerating any further breaches beyond a reasonable, say, two to three days. The customer has been informed accordingly.

Pending further developments with the proposed bond issue from this distance, I have considerable doubts that it will proceed. I propose that you join with me in approving extension of the limits subject to the scheduled review by 31/10/98 and a continuing count on outstandings at the current AUD \$53.76 million. I have no problem with the favoured scenarios (a) or (b) in Jock Frazer's memo of 2/10/98 but we may need to consider something else depending on what transpires. Everyone understands the basis on which we entered into these facilities and I continue to be comfortable with them. However, there are some major issues about to impact which will need to be intensely worked through to ensure that we want to continue.

If you agree, evidence of your approval on the general overview page would be appreciated by fax."

[11.49 am] We also note from commission document 457 that David Bell head of business banking for ANZ (PNG) and Justin Brehemy, regional manager business banking Asia Pacific had approved the credit memorandum on 6 and 7 October 1998 respectively. A copy of the approval is evidenced in tendered document B1560.

On 12 October, 1998 ANZ diary note records that NPF had come back to ANZ's response to queries raised by ANZ arising from the review of NPF's facilities. The responses received were recorded in ANZ diary note found in commission document 457 page 401 to 411 and which will be tendered as document B1562 to 1564.

The responses from NPF were not in our view have given ANZ much comfort as the answers did not seem to address the underlying issues raised by ANZ. "To document NPF's responses to a number of questions raised in letters dated 31/08/98 and 22/09/98. What are the fund's targeted portfolio weightings for government securities, equities, term deposits, property long term development, loans/debentures for 1999 and beyond.

Target weightings are set by the finance minister. The current weightings were set by Sir Julius Chan in 1993 and below they are summarised along with our current weightings. Guidelines and Actual - two columns. Government securities, guideline 30 to 40 per cent, actual 9 per cent. Term deposits, guideline 10 to 20 per cent, actual 23 per cent. Commercial equities, guideline 20 to 35 per cent, actual 57 per cent. Properties guideline 20 to 30 per cent, actual 10 per cent. Loans debentures guidelines 10 to 35 per cent, actual 1 per cent. How does the fund intend to achieve the targeted weightings? Will the fund's targeted portfolio weightings meet with the government's suggested weightings for investment activities and if not, why not?

As you would appreciate, investment opportunities in developing nations are limited and as a result, it is extremely difficult to adhere to the above guidelines as set by the minister. It should be noted that the board is aware of the guidelines and as a result, the fund is building the tower to increase our exposure to property and we continue to assist the government via loans for projects to increase our exposure to government securities.

What are the specific investment strategies and rationale for each of the fund's equity investments in 1999 and beyond, ie, for each equity, does the fund plan to hold, sell, acquire and why?

[11:51 am] Steamships Trading Company, the most under valued investment in our equity portfolio and as a result the strategy for 1999 will be to hold. Collins and Leahy Holdings. Very sound company with a conservative valuation policy. C and L holds 33 percent of STC. Our future strategy will be to hold. Highlands Pacific Limited. HPL owns two major projects being Ramu Nickel and Nena Frieda Copper/Gold at a bankable feasibility stage and also significant exploration. The share price has been hit very hard by the down turn in the resource sector and the general state of world economies. 1999 will be to hold and sell down during the construction and production phases of Ramu and Nena.

Vengold. NPF is the largest shareholder in Vengold with 17 percent. The NPF will hold this investment until a take over is announced by Placer Dome. Our strategy remains unchanged since April 1997. Macmin. Macmin share price has also suffered over the past year due to the down turn in the gold price. It would be difficult to sell out of Macmin in the current market. However, NPF would look at reducing our exposure after things begin to recover globally.

Cue Energy. Cue's share price has also been hammered due to lower oil price in 1998 and perhaps more importantly, a recent law suit against Cue has resulted in further downward with pressure. We will be discussing the future of Cue at the October board meeting. Please provide details of (a) security pledged and repayment terms on the Bank of South Pacific and the Papua New Guinea Banking Corporation facilities. Also, could you please advise details of the Bank of Hawaii transaction, that is, amount of loans, repayment terms, interest rate, security pledged by NPF et cetera. BSP loan 15.1 million the security pledged as follows. Term deposits, PNGBC 3 million, term deposit Bank of Hawaii, 2 million, term deposit BSP 1 million, term deposit BSP 8,229,700, total, 14,229,700. In addition to the above term deposits, BSP also hold security over 100,812 Orogen Mineral shares valued at AUD\$4,258,200 on 30/9/98. The loan is an interest only loan, however, it is the intention of the fund to retire debt as the term deposits mentioned above mature. PNGBC Tower loan. K29.2 million, limit K50 million.

[11:54 am] Security pledged to secure the tower loan is basically the building itself and 4.9 million Highlands Pacific shares. The loan is a 10 year interest only during the construction phase and then principal and interest after the completion.

Bank of Hawaii. The NPF have sold K59 million and K5 million Poreporena Highway and Eda Ranu loans respectively to the Bank of Hawaii in November/December 1997. The sale price was K82 million and the deal involved NPF leaving the proceeds of the sale on term deposit with Bank of Hawaii as security over the government loans Bank of Hawaii had purchased from us. The interest rate on the term deposit is fixed at 8.5 per cent.

What is the prospect of the government repaying the POSB 23.8 million loan within the next 12 months and what are the repayment arrangements for this loan? The 23.8 million government loan will be an interest only loan with principal repaid in 10 years.

A listing of NPF's unencumbered assets. The current unencumbered assets are as follows: 8.2 million Collins and Leahy shares, value K58.6 million; 4 million Orogen Minerals, value K11.4 million; 1.4 million Vengold shares, value K2.7 million; government debt/loans 37.1 million; NC

loan 1.3 million; properties and WIP 15 million; total K126.1 million."

The diary note concluded that the interim credit memorandum will be prepared on receipt of detailed budgets for 1999 and receive rationale for continuing with its attempts to raise a AUD\$54 million bond given the existence of: (a) currency instability; (b) high interest rates; (c) declining commodity and share prices.

NPF's facilities were now under the strict control of ANZ, and NPF because of its financial position and the external economic and share market conditions were clearly struggling to meet its security covenant of 150 per cent. However, by 25 November 1998 we note that the ANZ banking group PNG's view was somewhat more optimistic than what had been evident from the email, diary note and correspondence seen in the period June to November 1998.

THE CHAIRMAN: Now, do you think we should stop now for lunch?

MR WARDLEY: I think yes.

THE CHAIRMAN: You have got more coming in after lunch, have you not?

MR WARDLEY: Indeed, we - definitely.

THE CHAIRMAN: So I think this is a good spot to stop and we will resume at 1.30.

MR WARDLEY: Certainly.

THE CHAIRMAN: Thank you.

MR WARDLEY: Thank you.

#### ***LUNCHEON ADJOURNMENT***

[1.50 pm] THE CHAIRMAN: Okay, well, I will declare the session open again. And Mr Wardley, are you ready to continue?

MR WARDLEY: Yes, Chairman, thank you. The recommencement of this session will be on page 167 of the new set of papers that are with you.

THE CHAIRMAN: Okay, thank you. Yes, thank you.

MR WARDLEY: A diary note found in commission document 457 offered a more positive outlook as follows, and we quote: "Mike, here is an information diary note to bring you up to date. I am very comfortable with our position going forward. The fund's cash flow is sound and we now have a better spread of equities and security. I have sought clarification of the issue relating to contribution from associates which seems to be a double dipping given the respective companies pay dividends in the normal way to shareholders and those dividends are included in cash forecasts. At this point it seems NPF owns upwards of 37 per cent of Collins and Leahy and upwards of 33 per cent of Steamships. You will note I hope to have everything bedded down pre-Xmas." A copy of this fax will be tendered as document B1565.

Consistent with this view we find that a diary note dated 28 December 1998, commission document 457, prepared by Mr Jenkin records a review of NPF's financial results to 30 September 1998. Interestingly the diary note records that in respect of financial performance of NPF, "The fund's underlying profitability and cash flow remain sound." And in respect of the bound sheet of NPF, "Overall the balance sheet as at 30/9/98 remains sound despite the impact of the declining share values and exchange rate losses on the ANZ FCL facility."

[1:53 pm] A copy of the diary note dated 28 September 1998 will be tendered as documents B1566, 1567.

THE CHAIRMAN: The changes on these numbers - it ends up being five.

MR WARDLEY: It does end up in five, yes.

THE CHAIRMAN: Okay, thanks.

MR WARDLEY: The conclusion drawn about the profitability of the fund was reached because ANZ adjusted NPF's reported results to eliminate the effects of revaluation for fluctuations in share prices for investments and also the exchange rate gains and losses on the foreign exchange currency loan. The rationale behind this adjustment, we assume was to identify the underlying performance of the fund. However, it is difficult in our view to understand the relevance of this adjustment in a provident fund where there were clear indications that the fund was in financial difficulties due to a burdensome and debt problem and falling asset values. Where A- - -

THE CHAIRMAN: It is true, is it not. Because the ANZ's reaction to it, is eventually going to be based on the actual figures not the adjusted figures.

MR WARDLEY: Not the historical figures, correct, yes. Where ANZ's security was also in default, the most relevant issues for ANZ were (1), the market value of shares and (2), cash flow projections. ANZ were certainly aware of these issues but at the same time, the positive conclusions drawn by ANZ in terms of financial performance and financial position appears strange given the known facts. On 6 January 1999, diary note prepared by Mr Jenkin, manager business banking records a verbal update given by Mr Wright as well as an explanation as to why the annual audit had not been completed. Mr Wright's explanation was recorded in the diary note as follows:

"Annual audited accounts. NPF submitted their 1997 accounts to the auditor general in May 1998. The auditor general contracts out the audit process to the large accounting firms. Deloitte has completed NPF's audit for the past five years but are unlikely to get the job for the 1997 accounts. To date, the auditor general has not even advised NPF who the auditor will be for the 1997 accounts.

[1.55 pm] NPF's contact in the auditor general's department is on leave until 26/1/99. Noel Wright has undertaken to follow the matter up on his return from leave. Once again, delays in receipt of the information is due to PNG Government bureaucracy." A copy of this diary note can be found in commission document 457 and will be tendered as document 1568.

What is noted in this diary note as having been stated by Mr Wright, is inconsistent with what the Auditor General has stated in the covering letter supporting a file submitted by the Auditor General's office to this Commission of Inquiry. The file in question can be found in commission document 102 and indicates and in fact the authorised auditor, Deloitte Touche Tohmatsu had completed its audit field work and had submitted the audit files to the Auditor General in respect of the year end 31 December 1997 by June 1998. A copy of an extract from a letter of submission presented to the commission, will be tendered as document B1569. Based on ANZ diary note, it would appear that Mr Wright was far from honest and was economical with the truth in his representations to the bank.

On 25 January 1999, we find further evidence that ANZ were comfortable with their position with NPF. A diary note evidenced the senior manager credit perspective on this issue. "Guys, in note, there are two breaches of covenant both of which have been addressed within the body of the CM. For my part, I am comfortable with the explanation and recommendation of the account controller. Neither breach is material in the context of the group's accounting methods, and I believe we should be tolerant. Down grade to CCR 5B is appropriate in the circumstances and supported.

Of most interest in the delay in providing completed audited financial data for the period 31/12/97, and I have asked Tait Jenkin to once again approach the fund's financial controller to expedite matters. Information relative to the make up of the board, will then complete our file. The developments over the past three months have been of significant net benefit to the bank and we are comfortable with our exposure going forward.

[1.57 pm] I believe the relationship has been strengthened and we can rely on improved provision of information throughout 1999. Review date of 6/99 remains on schedule and it is timed to coincide with the completion of the NPF tower." A copy of this e-mail will be tendered as document B1570.

THE CHAIRMAN: Can I just ask, I suppose I am labouring under the impression that if a client is going down, the bank is also in trouble. That comment does not seem to have that same - does

not reach that same conclusion because it seems that developments over the past three months which have seen this pressure on the NPF and the bank having to pull in securities and everything, have been of significant nett benefit to the bank so that the bank is actually better off because of the difficulties and because they have got these securities in or is it just - it has made a bad situation slightly better. What do you feel is meant there, Mr Wardley?

MR WARDLEY: As you have said, the bank had put a lot of pressure on over the past few months to increase its security position and had achieved that quite successfully which puts the bank in a better position in that it has now more than adequately secured its current position. But whether they have really got an understanding of the implications as to where the Fund is headed is not clear.

THE CHAIRMAN: Yes, it is a bit like a - no, I better not say that. All right, thank you.

MR WARDLEY: From earlier hearings, the commissioners may recall that there had by end of January 1999 been the following changes in senior management. Mr Wright, January 1999, no replacement. Mr Copland, May 1998, replaced by Brown Bai. Mr Kaul, May 1998, replaced by Henry Fabila.

[2.00 pm] In the meantime ANZ had also prepared a further credit memorandum as at 31 December 1998. A copy of this credit memorandum will be tendered as document B1573 - 1582.

On 4 February 1999 a Mr Dempsey, regional credit executive, Asia Pacific, sent a memorandum to K. McNamara, head of business banking for ANZ in PNG and Mr Frazer, senior credit manager, which questioned the logic of certain aspects of the credit memorandum. "Re National Provident Fund board of trustees information CM of 8/1/99. Your advices including down grade to CCR5 are noted. Thank you. The following observations are made. A net loss before tax of PNGK28.93 million, AUD\$21.4 million has been recorded due to diminution in the value of equity investments PNGK28.1 million, AUD\$20.8 million, and FX losses and foreign currency loans PNGK12.8 million and AUD\$9.5 million as a result of PNG kina depreciation.

The improvement in the value of shares and PNG kina FX at a future date is not a guaranteed event. And given that the company is in the business of managing investments connected with the provident fund of private sector employees, it is inappropriate to discount the fact that these losses are real.

In view of the above, I have difficulty with the concept that the financial covenant breach relative to the interest cover ratio is considered technical. If the covenant intention is to measure immediate cash flow, then perhaps it would be more appropriate to redefine the covenant to the extent that it is relevant without adjustments. Current ratio breach can be considered technical provided the bank facilities referred to are genuinely noncurrent, i.e. long term and not just annual revolving as in the case of ANZ facilities.

Comments such as members' contributions are not being taken to profits under prospective analysis commentary are not relevant as such contributions are enough to tax adjustment towards NPF's equity and not income."

[2:03 pm] A copy of MJ Dempsey's memo will be tendered as document B1571 - 1572. The points made by the regional credit executive would appear to us based on the available evidence to be valid. Annotated to the memorandum found in the commission document 459 was a hand written note which noted that the use of historical figures by ANZ PNG was based on policy instruction. Reviewing the credit memorandum, we also note the following matters of interest. The current risk grade was recorded as 4B and the credit memorandum proposed that this be down graded to 5B. The credit memorandum concluded that the risks associated with NPF's facilities were acceptable because sound cash flow, underlying profitability remains healthy, sound balance sheet position, share cover of plus 160 percent and acceptable spread of equities, satisfactory returns of being achieved. The credit memorandum also reviewed the 1999 budget and based on sensitivity analysis performed it was noted that the budget model was most sensitive to interest rates and therefore, analysis was undertaken on interest rates sensitivities.

Sensitivity analysis. "Sensitivities performed indicate that the model is most sensitive to movements in interest expense rates (NB interest income rate are predominantly fixed for 1999 and are therefore unlikely to vary significantly from budget. Refer also comments contained in addendum.) Sensitivities performed: domestic interest expense rate increased to 30 percent, indicator lending rate is currently 21 percent. Off-shore interest expense rate increased to 10

percent. SIBOR is currently 4.7 percent. Facilities with Papua New Guinea Banking Corporation, K50 million. Bank of South Pacific, K15.5 million and ANZ PNG, Australian dollars 53.76 million assumed to be fully drawn. Commentary, the sensitised model, evidences lower net profit before tax of K11.3 million and reduced interest cover of 1.45 to 1. Note best members' contributions of PNG kina, 12 million were not however taken to profit. Should interest cover fall below 2 to 1 loan covenant, the fund has capacity to reduce borrowings from sale of liquid assets. The majority of the fund's assets are of a liquid nature. Domestic interest rates however, occur to have peaked in August 1998 and have since reduced by 2000 basis points. The PNG treasury have forecast average interest expense rates of 13 percent for 1999.

[2.06 pm] Offshore interest expense rates appear to be stable. (SIBOR is currently 4.7 per cent). Net cash after operations of K0.742 million in 1999 is after expenditure of K12.4 million on the NPF Tower Project. Construction is scheduled to be complete by April '99 and is being fully funded by the PNGBC K50 million loan facility. No allowance has been made in projection for rental income from the NPF Tower."

What the analysis did not look at though was NPF's sensitivity to share market price fluctuations. NPF's portfolio was highly concentrated in the resource equity market of the ASX and this can be a volatile and cyclical sector of the share market.

As at 31 December 1998, according to the audited financial statements of NPF, a copy of which can be found in commission document 6H, shows that the equity investment portfolio of NPF was concentrated in five major shareholdings valued to approximately K192.5 million and representing 91 per cent of equity portfolio and 55 per cent of total value of investments. These shares were: Collins and Leahy K53.5 million; Highlands Pacific K25.1 million; Orogen Minerals K22.3 million; Steamships Trading Company K47.9 million; Vengold K43.7 million. Total K192.5 million. A copy of the relevant extracts of the financial statements will be tendered as document B1583.

A significant fall in value in any one of these shareholdings would obviously have had a significant impact on NPF's financial position and ANZ's security.

February 1999. Through February 1999 ANZ diary notes, found in commission document 457, record NPF rolling over the various loans maturing. The loans were rolled over for between 60 and 180 days. A copy of the relevant diary notes tendered as documents B1584-158H.

ANZ diary note dated 26 February 1999 reveals a significant turn of events where NPF had engaged PriceWaterhouseCoopers to perform an independent review of NPF's investment portfolio.

[2.09 pm] A copy of this diary note will be tendered document B1589. The diary note reported significantly that PWC had made a number of recommendations which would impact upon ANZ facilities. The diary note recorded these as follows: "Review by Price Waterhouse Coopers. Paul Marshall of PWC has recently presented a draft review of NPF's operations and investments which had been undertaken at the request of Henry Fabila. Mr Fabila ultimately intends to make the main findings known to the Fund's members. He indicated that one of the main recommendations was for the Fund to reduce debt levels via; (a) sale of equity in the NPF tower; and (b) sale of shares. Proceeds from sale of shares will be used to reduce the FCL with ANZ.

According to Henry Fabila, the PNG Harbours Board have been instructed by the Prime Minister to purchase 50 per cent equity in the NPF tower. A valuation is to be undertaken to assess the CM. The PNG Harbours Board are believed to have approximately K11 million on term deposit. A balance of the equity could be on loan basis from NPF. NPF would use the sale proceeds to retire debt to the PNGBC.

NPF currently have some K14.9 million invested in PNG government treasury bills and some K8 million on term deposit with the PNGBC. The treasury bills are due to mature shortly and the proceeds will be used to reduce the debt with the BSP.

Another recommendation of the PWC review is that NPF refrain from investing in various projects BG SHP loans, private hospital, et cetera until the Fund's debt levels have been reduced to more manageable levels."

The message from the report prepared by PWC was loud and clear. The Fund was suffering from poor financial performance and a chronic debt problem. As an interim measure, PWC

recommended NPF develop a short term cash flow strategy to enable the Fund to service its debt obligations and that would then give NPF time to develop a medium to long term strategy to restructure the Fund's portfolio.

A copy of the report prepared in February 1999 by PWC can be found in commission document 308 and given its significance to NPF's approach to ANZ thereafter will be tendered as documents B1590 to 1638.

The executive summary of this report bears reading in full and will help the commissioners put into context what occurs from this point herein.

"Executive Summary.

#### 1.1 Summary of findings.

From a relatively conservative position in 1995, the National Provident Fund appears to have adopted a relatively aggressive investment approach.

The following current attributes of the investment portfolio indicate a risk seeking attitude to investment rather than risk averse. A majority weighting of equities in the investment portfolio, 53 per cent at market value at 31 December 1998. A majority weighting of resource stocks in equity portfolio, 69 per cent at cost at 31 December 1998.

Many substantial shareholdings rather than passive minority interests. A large exposure to potential growth stocks rather than mature income generating stocks.

A significant level of gearing. Due primarily to the recent down turn in commodity prices, the resource stocks within the investment portfolio reflect substantial unrealised loss at 31 December 1998.

[2:12 pm] The low level of cash generated from the equity portfolio and the commencement of major construction work on the NPF tower have been contributory factors in the NPF's current cash constraints. The NPF's projected cash flow for 1999 indicates that there is a short term funding requirement of K5 million to K10 million. The NPF board must develop as matter of urgency a short term investment strategy to address this issue. There does not appear to be a formal investment strategy underpinning the investment activities of the fund. The existence of such a plan may have been brought to light at an early stage the portfolio imbalances noted above.

During our review, we have noted weaknesses within the accounting and investment functions which whilst being outside the scope of this report, merit further consideration by the board. 1.2. Recommendations to the board. Short term cash flow strategy. The board needs to develop a short term cash flow strategy to address the following. The repayment terms of the current over draft facility of K6.5 million with the PNGBC. The need for further finance to complete the NPF tower. We estimate the funding requirement to be K5 to K10 million short. Options open to the NPF to raise cash in the short term include, raising of additional short term finance, extending or increasing existing short term facilities, the sale of equities, the sale of an interest in the NPF tower, the early repayment of the NIC loan. We consider the priorities for the funds raised to be as follows. Satisfying the PNGBC's facility terms and any changes that that can be negotiated. Completing the construction and commercial letting of the NPF tower. Maintaining a reserve of cash and equity to manage the ANZ loan facility. In addition, we recommend the board reviews its 1999 budget to identify areas where costs maybe saved.

1.2.2. Medium and long term investment strategy. The board should address the following weaknesses within the investment portfolio. The large exposure to equities. The lack of diversification within the equity class. The substantial shareholdings held. The high level of gearing. The board should consider dealing with the above issues as part of a well planned formal investment strategy. The starting point for the board should be the establishment of medium and long term investment objectives in respect of which strategies can be developed. We recommend that the board consider the following aspects of investment strategy when preparing its investment plan. The interests of the members of the fund. Any government priorities or requirements and investment guidelines they are obliged to comply with. Liquidity and cash flow management. Trade off between risk and return. The maintenance of purchasing power of money.

1.2.3. Other matters and Price Waterhouse Coopers recommendations. We recommend the board considers redefining the role of the finance and investment manager prior to recruiting for this position.

[2.16 pm] We recommend that the board review the fund's accounting policies with respect to equity accounting and the Bank of Hawaii transaction.

In view of the performance of the fund in 1998, we recommend the board reviews the draft financial statements for the year ended 31 December 1997 prior to signing the management declaration.

We recommend the board assesses the adequacy of the accounting function and address any areas of weakness found.

We recommend the board reviews its rights and obligations with respect to interest withholding tax and value added tax.

We recommend that the board ensures that the NPF is well prepared for any potential deregulation of the superannuation industry."

It would be difficult to argue against the general thrust of the conclusions drawn by PWC. NPF really, at this stage based on known facts, had little option but to develop a debt reduction strategy. It is also relevant at this stage to note that the issue of NPF's lack of power to borrow had still not surfaced.

From ANZ diary notes, commission document 457, we can see that between 25 to 27 February 1999, Mr Frazer, the senior Credit Manager and Mr Jenkin, Manager Business Banking, exchanged emails which highlighted ANZ's attitude to NPF. An uneasiness about the facility is evident. "From Frazer Jock, Vanuatu, to Jenkin Tait, Waigani; cc Harris, Chris, PNG; McNamara Kirk; subject: re NPF; date: Thursday 25 February 1999, 8.04 am.

Tait, is there any reason the FCL has taken so long to be prepared. We struck these agreements months ago. I think we should consider a time limit attached to the need to obtain ministerial approval and a penalty imposed if the deadline is not met. What do you think?

As far as I am concerned, the fund is in breach of its agreed covenants. My understanding is that HP shares were to be handed back; obviously not the case. Certainly we were not to rely upon them. I do not have the file to review what our approved conditions were. Can you advise?

Why is it so difficult to get Cvs? Does the PWC review set an appropriate guideline regarding the timing of debt reduction. What does the PWC review define as manageable debt levels?

I remain uncomfortable about the future of NPF and look forward to some positive action in regard to debt reduction. I believe we should be thinking about how low we want to go when the shares start to sell - \$25 million? Lower?"

[2.20 pm] In response Mr Jenkin sent the following email: "Jock. We purposely delayed preparation of our FCL agreement until the review process had been fully completed. At the time our ARCM submitted to ICO 2/10/98, we did not know which way the Australian dollar bond issue was going. We did not have a P and L budget for 1999 and we were awaiting a host of other details from NPF for inclusion in a subsequent interim review required by ICO. An information diary note was submitted 23/11/98 advising among other things, that the bond transaction would not be proceeding and our interim review was submitted to PNG credit on 31/12/98 and onforwarded to Singapore on 8/1/99. Singapore replied on 4/2/99.

We instructed Carter Newell Lawyers to prepare a revised FCL agreement on 8/2/99. They provided us with a draft document last week and they are currently attending to a number of amendments requested by the bank. We should be in a position to deliver the document to NPF next week.

For the record, NPF were advised in writing by letter dated 31/8/98 that the facility had been capped at AUD\$53,760,533 and we insisted at that time on share cover in excess of 160 per cent.

I am comfortable imposing a deadline for obtaining ministerial approval of say 45 days from the

date of the FCL agreement, i.e. usual time allowed for acceptance of loan agreements. I will arrange for Carter Newell to incorporate this as a condition of approval in the FCL agreement. NB: the FCL agreement already contains a penalty clause for breach of terms.

We agreed in late November to replace the 68.1 million Highlands Pacific shares, CMV as at 23/11/98 AUD\$22.46 million with 8.1 million Collins and Leahy shares, CMV as at 23/11/98 AUD\$40.5 million. The 8.1 million Collins and Leahy shares were received by ANZ Nominees on that day. NPF did not however push for the release of the Highlands Pacific shares and ANZ Nominees continued to hold the shares to this day. I agree that the understanding is that the bank does not want to place too great a reliance on Highlands Pacific shares, but other covenants do not specifically state this to be the case.

I have let Henry Fabila know that the bank wants additional shares lodged sufficient to ensure that NPF's share cover exceeds 160 per cent excluding Highlands Pacific stock. He had undertaken to arrange the transfer of stock from HTM Wilsons and I will be following this matter up with Henry on Monday.

(N.B. Kirk and I will be meeting with Henry Fabila, Herman Leahy and Haro Mekere, senior investment analyst on 1/3/99).

[2.25 pm] I agree. It should not be too difficult for NPF to provide CVs for its board members. Having said that, however, I have been requesting this information for months. The main reason given by Henry Fabila for the delay is that the majority board member three year tenures expire this month and that there are likely to be a number of changes. Henry has undertaken to provide the CVs as soon as the make up of the board has been determined and approved by the minister. We will continue to pursue this matter.

According to Paul Marshall, the draft review presents NPF with a number of options. One is for PWC to develop for NPF a non disruptive medium term strategy, say 6 to 12 months for the sale of equities with a view towards reducing NPF's borrowings, ie, PWC a recognisant that NPF hold major positions in thinly traded stock and that the Fund is required to maintain share cover with ANZ in excess of 160 per cent excluding Highlands Pacific.

Such a strategy would incorporate timetables for share sales debt reduction. The strategy would most likely concentrate on the sale of Steamships and Collins and Leahy shares and possibly to a lesser extent Vengold.

NB NPF are still digesting the contents of PWC draft review and have yet to give PWC the go ahead to prepare such a strategy document. We will raise this topic at Monday's meeting with Henry Fabila and provide you with an update.

In Paul Marshall's opinion, the investment strategy of the previous NPF Board chaired by David Copland and management Robert Kaul and Noel Wright was towards the high risk end of the spectrum and was not in the bests interest of the Fund's members.

In particular, Paul considers it inappropriate for a superannuation fund to have borrowed for the purchase of equities and he points to the fund's draft nett loss of K40.4 million for 1998 arising from the diminution in the value of shares K44.2 million adverse exchange rate fluctuations on the Australian dollar loan K10.1 million and interest expense K13.9 million.

I am therefore of the opinion that any strategy documents to be prepared by PWC would likely recommend to NPF that the Fund significantly reduces and or repays the ANZ FCL in full over a 6 to 12 month time frame."

In reply Mr Frazer sent the following e-mail: "From Frazer Jock Vanuatu to Jenkin Tait Waigani. Copies Harris Chris PNG, McNamara Kirk, Moore David. Subject: Re-NPF, Date: Saturday, 27 February 1999, 10.41 am.

Thanks Tait. I did not mean to be short and appreciate your feedback. I agree with PWC fundamental assertion that the Fund has perhaps been a little unwise in some of its investment decisions over the last two to three years.

I feel very confident our exposure is sound and our relationship with Henry Fabila is strong. I just hope the" expletive deleted "pollies stay out. That is the one reason we must stay close. The down side for us and Kirk is the almost certainly that 10 per cent of our assets will disappear."

Concerning this last e-mail, firstly, what has to be remembered though was that NPF had utilised ANZ's facilities to make these investments and secondly, we note from this e-mail how significant in terms of ANZ's loan book the NPF account was to ANZ. The e-mail records this at 10 per cent of ANZ assets. A copy of this exchange of e-mails will be tendered as document B1639 to 1640.

[2.28 pm] March 1999. By March 1999 following PWC's report on NPF's investment portfolio, NPF were fully aware of the poor financial position that it faced and it is also clear that NPF had been advised by PWC to review its debt position. NPF would also have seemed to have instructed Mr Marshall of PWC to liaise with ANZ in order to keep them fully apprised of NPF's plans. Again ANZ internal e-mails recorded these developments as follows: "Jock, Paul Marshall of PWC has now been formally instructed by Henry Fabila to prepare a strategy document for the fund which will initially focus on (a) liquidating shares and paying down the ANZ FCL facility and (b) actively pursuing interests in the Deloitte Tower. Paul believes that it will take him another day or so to assess the equity situation. Initially, he intends speaking with Chris Pratt to ascertain whether John Swire and Sons are interested in purchasing the Steamships and/or the Collins and Leahy shares. He will also approach POSF. Paul Marshall has undertaken to keep the bank fully involved in the strategy process and Henry Fabila has stated that he has no objection to providing ANZ with a copy of the PWC strategy document. I will keep you posted."

Another e-mail stated: "Purpose of diary note. Document, telephone conversation with Paul Marshall of PWC to discuss the mechanics of repayment and pre-payment of the FCLs from sale proceeds of equities. Options discussed: (1) coincide sale of equities with the end of the FCL interest period. (2) Lodge share sale proceeds in an ANZ Nominees cash management account pending the end of the FCL interest period and then repatriate the Australian Dollars to PNG to repay the advance. (3) Repatriate share sale proceeds to ANZ (PNG). Convert the proceeds to Kina and place the funds on ANZ term deposit pending the end of the FCL interest period and then convert back to Australian Dollars to pay out the advance. (4) Same as (3) above but with a foreign currency swap. According to Keith McKay this option would require Central Bank approval. (5) Pre-pay the advance upon payment of interest to the end of the interest period.

Paul Marshall indicated that option 2 appealed to him most, but that NPF board would ultimately need to decide. At this stage Paul envisages liquidating Oregon Minerals 8,314,400 shares with CMV AUD\$11.9 million and possibly Cue Energy 52,742,086 shares, CMV AUD\$1.3 million, and Macmin 21,876,409 shares, CMV AUD\$1.3 million over the course of the next one to two weeks. Patrick Butler of ANZ Nominees has undertaken to provide me with an indicative interest rate for cash management accounts. Paul mentioned that he has held initial discussions with Chris Pratt regarding the sale of the Collins and Leahy and Steamships Trading Holdings to John Swire and Sons. Whilst it is still too early to say, Paul anticipates that it will take up to two months to liquidate the Collins and Leahy and Steamships Trading Holdings."

Clearly PWC had recommended a debt reduction strategy and Mr Marshall was busy formulating a specific sell down program in line with this strategy. We have not undertaken any critical assessment of PWC recommendations and detailed strategy but prima facie, it seems from the evidence available that, the general approach and strategy adopted was one of the few practical options open to NPF. This may well be a particular aspect that the commission may want to review in detail at a later hearing.

[3:31 pm] ANZ's position with regard to its security coverage, 11 March 1999, according to ANZ's diary notes was as follows. AUD\$ facility, 53.76 million, less cash held by ANZ, 15.14 million, net 38.62 million, security, AUD\$ shares held 80.08 million. Again, according to the ANZ diary note, this provided ANZ with security coverage of 207.4 million whilst the loan covenant stipulated in excess of 160 percent. It should be remembered that NPF's facilities had recently been renegotiated such that the facility was now capped at AUD\$53 million and the loan covenant required NPF to maintain 160 percent security coverage previously had been 150 percent.

At March 1999, NPF's outstanding loan accounts were as follows. There is 16 different loans with a term between 60 and 180 days and varying interest rates in the 6.3 to 6.4 percent area. In total, these loans make up the 53.76 million principal outstanding. Against these loans, an ANZ diary note of 11 March 1999 prepared by Mr Jenkin recorded a share scrip with a market value of approximately AUD\$15.4 million had been released by ANZ Nominees for sale.

THE CHAIRMAN: Do you want those loans recorded into the transcript.

MR WARDLEY: If I may please, yes.

THE CHAIRMAN: Yes, I will direct that. The loans as referred to on pages 184 and 185 listed there of the notes be written into the transcript as they are there.

"Outstanding Foreign Currency Loans for National Provident Fund."

**No. Start Date Due Date Term Ccy Principle Rate**

1	18/01/99	19/3/99	60	AUD	4,527,500.00	6.394
2	19/01/99	19/03/99	60	AUD	2,400,000.00	6.394
3	19/01/99	19/03/99	60	AUD	4,206,009.81	6.394
4	01/01/99	02/04/99	60	AUD	494,745.19	6.931
5	18/02/99	19/04/99	60	AUD	100,000.00	6.479
6	10/02/99	10/05/99	90	AUD	184,204.73	6.424
7	10/02/99	10/05/99	90	AUD	6,765,933.50	6.424
8	10/02/99	10/05/99	90	AUD	3,458,502.51	6.424
9	10/02/99	10/05/99	90	AUD	3,588,335.87	6.424
10	10/02/99	10/05/99	90	AUD	1,054,867.95	6.424
11	10/02/99	10/05/99	90	AUD	2,304,388.50	6.424
12	11/11/99	11/05/99	180	AUD	15,750,000.00	6.402
13	24/11/99	23/05/99	180	AUD	2,156,985.38	6.655
14	11/02/99	10/08/99	180	AUD	6,084,650.00	6.424
15	11/02/99	10/08/99	1806	AUD	610,000.00	6.424
16	01/02/99	02/04/99	90	AUD	74,410.20	6.391

MR WARDLEY: Against these loans an ANZ diary note of 11 March 1999 prepared by Mr Jenkin recorded that share scrip with a market value of approximately AUD\$15.4 million had been released by ANZ Nominees for sale. However, the proceeds were to be held in a short term mini market with ANZ in PNG for repayment against the aforementioned loans. The shares identified for release were 7.5 million Orogen Mineral shares, 57.7 million Cue Energy and 21.87 million Macmin shares. A copy of the supporting diary notes can be found in commission document 547 and will be tendered as documents B1641 to 1644. In addition to this, ANZ encouraged NPF to provide a buffer above this level. It would appear from the evidence available that NPF management under the control of the managing director, Mr Fabila undertook to accommodate these requests without any resistance. The increased security provided ANZ with increased leverage in directing NPF strategy to maximise ANZ's security position.

On 16 March 1999, NPF seemingly at crisis point and still without a qualified finance or investment manager since January held a special board meeting. The board meeting in 1999 as will be becoming increasingly apparent to the commissioners saw the board struggling to come to grips with the realities of the financial problems faced by the fund.

[2.35 pm] At a special meeting of the trustees, the minutes record discussion on the financial position of the fund in relation to its debt exposure to ANZ. The last time this subject had surfaced at a board meeting was in May 1997 at the 106th meeting, some 22 months earlier.

At the special meeting held on 16 March 1999, Mr Paul Marshall from PWC presented the findings of PWC's draft report of its review of NPF's investment portfolio. The minutes record events at the meeting at minute reference 3.2 and 3.3 as follows:

"3.2 PriceWaterhouseCoopers review of investment portfolio. Mr Paul Marshall was invited into the board room. He was asked to present his summary of findings to the NPF board. The draft of a report on a review of NPF's investment portfolio dated February '99 was presented to the board. In the report that was presented, the following pertinent points were noted by the board: (1) The fund had moved from a relatively conservative position in 1995 to a risk seeking investment approach; (2) The fund had a high level of borrowings, which borrowings were used primarily to fund equity investments. This strategy had the effect of compounding the risk associated with the fund's risk seeking attitude towards investments; (3) When compared to superannuation funds of a similar nature in Australia, NPF's borrowings were high; (4) NPF needed to decide on what type of strategy to adopt going forward; (5) As of December 1998 the fund had sustained substantial unrealised losses which is attributed to its equity holdings.

3.3 Short term cash flow deficiency. Mr Marshall pointed out to the board that the board is required to develop a short term cash flow strategy to address the following urgent matters: (1) Repayment terms of the current overdraft facility of K7 million with the Papua New Guinea

Banking Corporation; (2) The need for further finance of between 5 and K10 million to complete the NPF Tower; (3) The need to satisfy margin calls on the ANZ banking which has been capped at AUD\$53 million.

Trustee Wayne Golding asked Mr Marshall to define certain specific financial terms used in the PriceWaterhouseCoopers report. After some discussions amongst board members, Mr Marshall was asked to leave the board room.

It was resolved to employ the services of PriceWaterhouseCoopers on a daily basis as a further measure to address the fund's short term cash flow strategy. The managing director informed the meeting that PriceWaterhouseCoopers were already engaged on a two day per week basis. It was resolved to increase this to a daily basis until the board was satisfied that the issues raised by the PriceWaterhouseCoopers report were being competently addressed."

[3.38 pm] We also find that in respect of this meeting that at minute reference 4 and 5, the following relevant issues were also recorded: "(4) Price Waterhouse Coopers Report. Mr Paul Marshall was invited into the board room. He informed the meeting that letters had been prepared and sent out to Bank of South Pacific Limited and the PNGBC in relation to NPF's short term funding requirements. He pointed out that the funding requirement was conditional upon NPF liquidating some of its assets in the interim period and that the banks had been informed of the fund's intention to liquidate its security holdings in the following companies; Macmin, Oregon, Vengold. Resolution: It was resolved to adopt the Price Waterhouse Coopers draft report in final form and without amendment. (5) Sale of shares proposal, Collins and Leahy. The managing director put forward a proposal for the sale of shares in the above company. Trustee, John Paska, tabled an objection on the following basis: (1) NPF was exiting the investment at a bad time given that the share price was trading at low levels and returns to the NPF from its investment in C and L over the years were good and that the problem with C and L and the losses incurred by the company last year are management related. The following points were noted in favour of NPF's sale of its share holding in C and L. The discussions had with Steamships Trading Company managing director, Chris Pratt revealed that the Swires group were reluctant to have NPF sell its share holding in STC. However, the Swires group were interested in making an offer to NPF for the acquisition of the fund's C and L interest, and NPF was already overexposed in the merchandising sector through its share holding in C and L and STC. NPF's average entry price for the C and L stock was AUD\$3.52. The stock was currently trading around AUD\$4.40, however, the published trading figures for the stock belie the lack of depth and liquidity in the market. Based on historical performance, the current yield for the stock was less than 2 percent per annum.

ANZ Bank position. The following points were noted in relation to NPF's exposure to the ANZ Bank under its foreign currency loan facility. The fall in the share price will trigger a margin call by the ANZ Bank which will require either of the following to be attended to by NPF: (a) Lodge sufficient share scrips satisfactory to ANZ to ensure 160 percent cover of ANZ Australian Dollar exposure under the FCL or (b) repay monies outstanding under the FCL to ensure 160 percent cover of ANZ Australian Dollar exposure under the FCL is at least equal to the aggregate of the share value and the Australian Dollar deposit at any time. The share price of the various stocks held as security by the ANZ for the borrowing which continued to decline. In recent weeks Vengold stock price had halved and the fact that ANZ attributed nil value to Highlands Pacific Limited shares."

THE CHAIRMAN: Is this indicating that because of the need to sell the shares, the price of the shares was beginning to drop? Is it related to the knowledge in the market that NPF was about to sell large blocks of shares?

MR WARDLEY: You probably need a broker to try to explain some of the nuances but obviously if NPF is perceived as a substantial shareholder and is off loading shares then the market obviously will weaken because there are not enough buyers in the market to take up the sale offer.

THE CHAIRMAN: Well, there is a comment at the very top of page 189: "The fall in the share price will trigger a margin call."

MR WARDLEY: That is in respect of the 160 percent security cover. As is the price - as the market price is driven downwards and as the ANZ mark there security each day, based on market price then the value for security purposes comes down and that 160 percent security cover will then reduce yet again.

THE CHAIRMAN: So, that fall in the share price is not referring to a fall induced by the sales but just the fact that they are falling, is that right?

MR WARDLEY: I think if it was market forces at work with commodity prices and resource stocks generally.

[3.44 pm] The specific strategy adopted thereafter, was a difficult and judgemental exercise and in the context reviewing NPF's facilities with ANZ, we have not reviewed the alternative strategies that may have been available to NPF.

THE CHAIRMAN: What do you mean detrimental exercise?

MR WARDLEY: I suppose they were basing their decisions primarily on proposed exit strategies by or debt reduction strategies that Price Waterhouse Coopers had put forward. At the end of day you never know whether that was the best strategy or whether, given different circumstances, other options may have been available. But I think in some ways, the NPF at this stage, were caught in a rock and hard place and really had got the time or the way with all to try to explore potential other alternatives to reduce some of the critical exposures which we are now faced with.

THE CHAIRMAN: Okay.

MR WARDLEY: Thank you. A copy of the relevant minute extracts will be tendered documents 1645, 1651.

THE CHAIRMAN: So you are not putting forward anywhere what alternatives strategies may have been possible.

MR WARDLEY: Not at this stage, if you would like us to explore those, and we certainly could do.

THE CHAIRMAN: Well, I will have to consider our terms of reference, I think, first to see whether we request that of you. Yes, thank you.

MR WARDLEY: I think perhaps you have picked up the question, because my next comment is the issue of how NPF dealt with the financial mess it found itself and particularly in regard to the period from June 1998 to June 1999, is an area that potentially this commission may wish to review as a separate subject. Therefore, in the context reviewing the ANZ facilities, we have not dealt with this issue in depth.

THE CHAIRMAN: All right, thank you, because it may well be something we need to look at.

MR WARDLEY: And in conjunction with the other aspects that had been looked up.

THE CHAIRMAN: Yes.

MR WARDLEY: Following this board meeting, we see from ANZ diary note files, a period of frantic activity as NPF and Mr Paul Marshall of PWC and ANZ sought to work out the strategy to reduce NPF's debt with ANZ.

In March 1999, we also found from correspondence sent by the Prime Minister at the time, the Honourable Bill Skate, CMG, MP, that specific directions were given to the managing director, Mr Fabila, that no new investments could be made by the fund. A copy of the letter sent by the Prime Minister will be found in CD54 and will be tendered as documents 1652, 1653.

Consistent with the debt reduction strategy, NPF wrote to Honourable Iain MacLennan, MP, as Minister for Treasury and Planning on 19 March 1999 seeking approval to sell down NPF's equity position.

[2.47 pm] A copy of this letter is found in commission document 54 and will be tendered as document B1655.

By 30 March, 1999 it is apparent from commission document 55 that NPF had not yet received the minister's approval. We also note from ANZ diary notes that Mr Jenkin of ANZ was pressuring NPF to remedy a breach in NPF's covenant whereby the security coverage was now

below 160 per cent. A copy of ANZ's letter requesting NPF to remedy this breach will be found in commission document 55 and tendered as document B1656 to 1658.

By 16 April, 1999 the Minister for Finance, Iain Macfarlane provided his approval. The approval provided NPF with the power to sell down the following investments. 8,169,679 Collins and Leahy shares, 57,622,086 Cue Energy shares, 72,877,733 Highlands Pacific shares, 21,876,409 Macmin shares, 10,126,400 Oregon Mineral shares, 7,317,742 Steamships Trading shares, 24,265,900 Vengold shares. A copy of the minister's approval can be found in commission document 54 and will be tendered as document 1660 to 1661.

The original brief to the minister was dated 19 March, 1999 and requested the approval of: (1) sell down of specific equities; and (2) the sale of 50 per cent of the equity in Tower Limited.

The proposal outlined the following and independent evaluation of the NPF's investment portfolio by PWC that NPF now sought the minister's approval to allow the sell down of the specified assets in order to effect PWC's recommendations. The request was made under the signature of the then managing director, Mr Fabila. A copy of the brief can be found in commission document 5E and will be tendered as documents B1662 to 1682.

The submission also enclosed draft letters of approval for the minister to approve. It is clear from the file submitted to this Commission of Inquiry that the initial brief submitted to the Minister of Finance did not include an NPF Board resolution in support of the strategy.

As a consequence, we note from a letter dated 26 March, 1999 sent by Mr Fabila to the minister that the secretary for Treasury and Planning, Mr Brown Bai had requested NPF to re-submit the proposal with the necessary board resolutions and for a reason not explicitly stated a revised draft letter of approval which excluded the sale of Collins and Leahy.

[3.51 pm] A copy of the relevant letter will be found in commission document 5E, tendered as documents B1686.

In response to this request it would seem that NPF management prepared a paper seeking the board's approval for the sell down of certain equities and 50 per cent in the tower and circulated this to the trustees. We say this because the revised submission made to the minister enclosed a resolution of the NPF board certified by the corporate secretary Mr Leahy. Again, it has to be stated that this method of board resolution was not permitted under the NPF Act and therefore was not a proper resolution of the board.

The brief to the minister requested that the minister provide NPF with discretionary powers to dispose of the shares, thereby allowing NPF the necessary flexibility to maximise its opportunities for sell down purposes.

It is clear from the correspondence submitted by the Department of Finance that the full financial implications of the proposal was not necessarily appreciated. Although the brief to the minister detailed the current market value of the shares against the historical cost of the investment, the internal briefs within the department did not dwell on this issue and its implications in any detail. Had they done so, it might be that they would have realised that at the date of the submission the fund stood to realise a loss of approximately K91 million based on the sell down of the equities. It might also have resulted in the department questioning NPF as to what alternate steps it had taken to address the issues.

THE CHAIRMAN: Could you just hold on a minute while I go through that again, please. Okay, thank you.

MR WARDLEY: The brief focussed solely on the fact that the strategy to sell down was needed to repay the debt.

April 1999. With the Minister of Finance approval in place, we find the NPF selling down its first tranche of shares in its divestment, whereby according an ANZ diary note dated 12 April 1999 Wilson HTM Limited sold 5 million Oregon Mineral shares on behalf of NPF for AUD\$8.05 million. A copy of the relevant diary note is found in commission document 457 and will be tendered to document B1687.

On 19 April '99 ANZ diary note, found in commission document 457, records the results of the NPF's management accounts for the year ended 31 December 1998. This confirms that NPF

financial performance and profits were significantly affected by the falling values in resource stocks, high costs associated with debt and foreign exchange losses.

[3:55 pm] A copy of this diary note will be tendered as document 457 and will be found in tendered document B1688 to 1689.

THE CHAIRMAN: We just go back for a moment. The fund has now got approval to sell off 5 million Orogen shares. Would they be shares that had previously been lodged with ANZ as security or is this a different parcel of shares or - - - ?

MR WARDLEY: I would guess that if the - if Wilson HTM was selling them - what I do not know is whether if Wilson HTM was selling them on behalf of the fund but the share scrip would then have to come over from ANZ Nominees. Or it could be shares which Wilson HTM was still holding unencumbered.

THE CHAIRMAN: So, we do not really know.

MR WARDLEY: We do not know.

THE CHAIRMAN: I am just wondering, I mean, who gains the benefits of this situation. I know the ANZ has been holding in ANZ Nominees bag of shares. Does it continue to hold them while NPF sells off other shares.

MR WARDLEY: Well, that is a possibility and that they still - and that would then effectively increase their security proportionately if NPF was selling unencumbered shares.

THE CHAIRMAN: Yes. So, and also would it be possible to report back on that.

MR WARDLEY: Yes.

THE CHAIRMAN: On that issue.

MR WARDLEY: Yes, I understand. Because it could vary - -

THE CHAIRMAN: Because it is going to come again I would think. There is going to be a lot of shares sold.

MR WARDLEY: Starting to be sold and if we are selling unencumbered shares then and reducing the loan facility then the ANZ security position is improving all the time viz a viz the residual balance.

THE CHAIRMAN: And they should releasing shares because they will not be needing eventually to hold additional shares.

MR WARDLEY: To hold as many shares, yes. Therefore, the percentage cover would be going up and up. But if they are secured shares then obviously just coming down on a pro rata basis.

THE CHAIRMAN: That sort of thing.

MR WARDLEY: Yes. On 19 April 1999, we also find a further ANZ diary note updating the status of the divestment strategy and given the significance of the losses incurred in 1999 on the sell down requires our review. "The fund has now embarked on a strategy to divest equities and substantially reduce/repay the ANZ FCL facility. Paul Marshall of PriceWaterhouse Coopers has stated the divestment strategy will be implemented over a period of six to 12 months. Current position is summarised below. Orogen Minerals. Sale of a 5 million tranche of Orogen Mineral shares was settled on 14/4/99. ANZ Nominees received sale proceeds of AUD\$8 million at settlement which have been lodged on STMM (Short term money market). The AUD\$8 million will be applied in reduction of the FCL facility on 10/5/99, that is next FCL maturity.

THE CHAIRMAN: Is that the answer to the question, ANZ Nominees received sale proceeds.

MR WARDLEY: They have received the proceeds and put them on the short term money market but it is still not answering the question whether those shares were part of their secured shares or in encumbered stock.

[3.59 pm] Vengold, Merrill Lynch are currently assessing the level of interest in Canada for this

stock. Paul Marshall expects to have an assessment by next week. Macmin, sale is imminent according to Paul Marshall. Cue Energy, Wilsons HTM believe that a price above market maybe possible for the stock and they will explore this possibility over the next few days to ensure that the best price is achieved.

Steamships Trading. Kina Securities and Pacific Capital are currently assessing local PNG interest for the stock. Paul Marshall expects the assessment to be completed by the end of this week.

Collins and Leahy. Offer of \$2 per share made by Swires (Chrs Pratt) but not accepted by NPF. Current market value \$3.55 per share. Kina Securities and Pacific Capital are currently assessing local PNG interest. Once again, the assessment is expected to be completed by the end of the week.

Update on NPF Tower. NPF are attempting to arrange the sale of 50 per cent equity in the NPF Tower to the PNG Harbours Board for 40 million. Sale proceeds will be utilised to substantially reduce the Fund's borrowings with the PNGBC.

According to Henry Fabila Managing Director, the General Manager of the PNG Harbours Board is currently availing of an overseas holiday. NPF will look to formalise a contract for sale of 50 per cent equity in the NPF tower on the general manager's return to PNG.

Paul Marshall is sceptical, however, that the PNG Harbours Board would have the capacity to purchase a 50 per cent equity in the NPF tower and he is aware that the PNG Harbours Board have yet to submit an application for finance to the PNGBC. Henry Fabila stated that Pacific Capital, Neil McIntyre have recently been instructed to seek out other equity participants for the NPF tower.

On the tenancy front, Henry Fabila advises that there has been plenty of interest in the NPF tower but still nothing concrete. Deloitte's have indicated that they want the 10th floor.

According to Paul Marshall, the PNGBC have recently approved an increase in NPF's fully drawn loan from K50 million to K59 million to achieve practical completion of the NPF tower.

Despite earlier assurances from NPF management that the building contract was fixed and would not exceed 50 million subsequent negotiations between NPF and Kumagai Gumi have resulted in adjustments to the contract price primarily due to exchange rate fluctuations. The BSP facility has reduced to 2 million according to Paul."

A copy of this diary note can be found in commission document 457 and will be tendered as document B1690 to 1691. Further sell downs in NPF's investment portfolio reported in ANZ diary note dated 28 April 1999 where NPF sold 1,801,209 MacMin shares for a consideration AUD\$73,400 through its broker Wilson HTM. A copy of the diary note recording the sale can be found in commission document 457 and will be tendered document B1692.

THE CHAIRMAN: What is the basis that brokers get commission? Is that on the sale?

MR WARDLEY: Yes.

THE CHAIRMAN: According to the value of the sale and so on goes commission.

MR WARDLEY: Yes, I think it is the percentage- - -

THE CHAIRMAN: The higher the sale, the higher the commission.

MR WARDLEY: Yes, it is a percentage. Although not being a share person, I am not sure what sorts of rates or anything like that.

[3.02 pm] April 99 board meetings. In April 1999 NPF held two board meetings. The first on 20 April 1999, the 118th board meeting and then subsequently a special meeting on 30 April 1999. We note that according to the minutes the ministerial approval had been obtained for increase in fully drawn loan facility from PNGBC from K50 million to K59 million. Sale of NPF equities. Sale of NPF 50 percent equity in NPF Tower limited, increase in overdraft facility with PNGBC K7 million to K9 million. A copy of the relevant extract of the minutes of this meeting will be found in commission document 51 and tendered as document B1693, 1695.

So, whilst NPF were embarking on a debt reduction strategy with ANZ, at the same time it was increasing its debt with PNGBC. In addition, the minutes recorded the following: "It was noted that the ANZ Bank had capped the NPF foreign currency loan facility to AUD\$53,760,533. It was noted further that the whole of the facility had been drawn down by the previous NPF board to purchase shares on the Australian Stock Exchange in PNG related resource stocks.

Documents. There was produced to the meeting the foreign currency loan agreement between Australia and New Zealand Banking Group (PNG) Limited and National Provident Fund.

Resolution. It was resolved that the entry into and the ratification of the entry into of the foreign currency loan agreement would benefit the National Provident Fund and to approve the foreign currency loan agreement and to ratify the execution by the NPF under seal of the agreement, and to approve the observance of the obligations of NPF under the foreign currency loan agreement. To approve of the security pledged by the NPF board to secure the foreign currency loan facility including the following: (a) General lien from National Provident Fund Board of Trustees. (b) Custodian agreement between ANZ Nominees and ANZ (PNG) covering the following publicly listed companies; Cue Energy, Vengold, Steamships Trading Company, Oregon Minerals, Macmin, Collins and Leahy Holdings, Highlands Pacific. (c) Deed of assignment over above listed shares. (d) Negative pledge. To authorise the managing director and the corporate secretary, whose specimen signatures appear below, to execute any document, notice or communication which is required to be or which may be delivered on behalf of NPF which may be considered necessary or desirable in connection with the foreign currency loan agreement or any such document, notice or communication or any matters contemplated by any one or more of them.

[3:05 pm] To request the Minister for Treasury and Corporate planning for such consents to the foreign currency loan agreements as is required by the National Provident Fund Act and the Public Finances Management Fund Act and any other governing legislation under which such consents or approvals are required. To approve of all documents produced at the meeting not otherwise specifically approved.

THE CHAIRMAN: Can we just look at this? Is this the retrospective approval of all the things that Noel Wright had previously been doing and agreements which had already been reached.

MR WARDLEY: Over the last six, nine, 12 months, I would say yes. The ANZ were rewriting the FCL agreement following on from a credit review of the facilities capping them at 53.7 million but we noted the first notification of that capping was many, many months back. They were then waiting for various preconditions of the offer to be fulfilled for instance they were waiting for the CVs to be received.

THE CHAIRMAN: So, is that what it is referring to, things subsequent to the capping or things prior to that.

MR WARDLEY: I think it is to the - - -

THE CHAIRMAN: What is the foreign country loan agreement referred to there at the very top of page 196?

MR WARDLEY: I think, it will refer to the capping of NPF's foreign currency loan facility which is noted on 195 where it is - it is noted the ANZ cut the NPF's foreign currency loan facility and following on from that capping, they then wanted to formalise that in the new loan agreement with about ten or so conditions precedent that had to be also resolved.

THE CHAIRMAN: I would not have thought that any approvals were needed for the actual fact that the ANZ had exercised its rights under the agreement which it had already entered into, which would be treated as a breach. It would be able to cap the facility that previously been approved. I mean, that is a unilateral action. The ANZ would achieve that if there as an agreement in place already. I am just wondering whether these foreign currency loan agreements which are now being put up to the board for approval, belated approval of things that had in place for the ANZ for sometime before that.

MR WARDLEY: Yes, and just thinking aloud. It could very well be that it relates to the agreement in principle whereby there would be the allowance where previously we had a kina facility and an Australian dollar facility and the proposal that those two would be effectively merged so that

there would just be one overall facility. I think it is perhaps necessary for me to go back in time so I can answer specifically your question.

THE CHAIRMAN: Yes. But it is- - -

MR WARDLEY: As to what this- - -

THE CHAIRMAN: It is approving the security pledged by the NPF board. And see, I would have thought those all happened earlier. But we need to look at what these documents are.

MR WARDLEY: As to which specific loan facility- - -

THE CHAIRMAN: Yes.

MR WARDLEY: We now are actually approving. It could very well be the merging of the non segregation of the kina and Australian dollar facilities which up to that point in time had been kept very separate.

THE CHAIRMAN: The negative pledge is in those- - -

MR WARDLEY: They would have already had those before.

THE CHAIRMAN: I would have thought, those were things which were previously entered into by Noel Wright on behalf of the board but never put to the board.

[3.09 pm] Now, the whole bag of stuff which had never been approved has been brought finally around to the board and the minister has also approved them. So, I am interested to know what is going on there.

MR WARDLEY: Okay, I will find out when we get back.

THE CHAIRMAN: And the last one, to approve of all documents produced to the meeting not otherwise specifically approved. That is a sort of throw-in-all sort of approach.

MR WARDLEY: Capturing everything, yes.

THE CHAIRMAN: And it is noted that the Minister of Finance approval had already been received. To what, I am not sure, that last one, for instance?

MR WARDLEY: It is noted that the Minister of Finance approval had already been received and so why throw it in at the end of a resolution?

THE CHAIRMAN: And how did he come to approve all the documents produced at the meeting but are not otherwise specifically approved. I mean, his approval could not have covered that one.

MR WARDLEY: For the minister's approval, the previous approval we had was for the divestment of the shares and so on. Unless it is one that is also going back quite some considerable time.

THE CHAIRMAN: I do not know what it is, Mr Wardley, but we should find that out.

MR WARDLEY: Yes, I will get explanations for them. On 30 April, 1999 the special meeting, the minutes recorded that Mr Marshall of PWC had been invited to attend NPF's Board meeting and provided an update on the NPF's divestment strategy: "Price Waterhouse Coopers Report - ANZ Foreign Currency Loan Facility. Mr Paul Marshall was invited into the board room. He informed the board that Tait Jenkin who was NPF's loan account manager with the ANZ Bank continued to inquire of Mr Marshall and the NPF management as to the NPF's future strategy in relation to the divestment of NPF's equity.

It was noted that the following divestment had already taken place in accordance with the previous strategy of the board to reduce the ANZ facility through the sale of its equities.

[3.11 pm] Oregon, 5 million shares at a price of \$1.61. Total proceeds of 8,050,000. Also Macmin, 606,409 shares at a price of 42 cents, proceeds of AUD\$25,590. Mr Marshall noted that

the ANZ had informed him that its target with NPF's foreign currency loan facility was that it be reduced to AUD\$25 million. The security over pledged by NPF to cover the foreign currency borrowing including Highlands Pacific Limited share scrip is around 170 percent cover. The ANZ Bank does not wish to accord any value to Highlands Pacific shares and therefore the cover, excluding HBL shares, were around 160 percent. The ANZ Bank has also noted the artificial trading price for both Collins and Leahy and Steamships Trading Limited. It was noted that despite the reported trading price for C and L of AUD\$3.05 and Steamships of AUD\$3.20, the bank is aware that the price offered for the whole of NPF's share holding in C and L is only \$2.25. Mr Marshall informed the board that it is common knowledge that NPF paid too much in its attempt to take over C and L and STC. Mr Marshall also informed the board that Ces Iwago of Merrill Lynch may have someone interested in NPF's equity holding in the Bank of South Pacific Limited.

Resolution. It was resolved to have Mr Marshall continue pursuing Merrill Lynch for their client's interest in NPF's equity in the Bank South Pacific. The chairman informed the meeting that overall it was still the board of trustee's intention to sell down its equity holding in various investee companies in order to reduce its overall debt exposure. However, the board were mindful of the low trading price of resource stocks which form the bulk of NPF's investments and that they were attempting to obtain, as far as possible, a better price for the stock before disposing of it.

[3.14 pm] It was resolved to have Mr Marshall arrange a meeting between the chairman and Tait Jenkin of ANZ Bank for 3 May. All of the trustees were welcome to attend that meeting."

May 1999. On 4 May 1999, ANZ diary notes record that ANZ, NPF Chairman at this stage, Mr Maladina, and Mr Marshall of PWC, met to discuss the progress on NPF's investment strategy. "Purpose of diary note. Document meeting held with Jimmy Maladina, NPF Chairman, and Paul Marshall, Price Waterhouse Coopers, at the offices of Carter Newell Lawyers at 2 pm. Kirk, McNamara, DMD and HOB; Jock Frazer, SCM, and Tait Jenkin, MBB, attended the meeting. Key areas of discussions are summarised below.

Share divestment strategy. JM confirmed that the fund is still actively committed to the divestment of shares with the aim being to substantially reduce the FCL liability.

KM stated that it is important that NPF and the bank agree on (a) a level that the FCL should be reduced to; and (b) a reasonable time frame for the FCL to be reduced to that level.

PM indicates that the fund is aware that the bank want the FCL liability reduced to, say, AUD \$25 million and that this level would be comfortable to the fund.

TJ sought update on the fund's share divestment strategy.

PM argued that sale of Colins and Leahy shares should be on an all-or- nothing basis. NPF have 38 per cent interest in Colins and Leahy.

Assuming a sale price of AUD \$2 per share, this could realise some AUD \$16 million.

[3:17 pm] A further AUD\$4 million could come from sale of Steamships Trading shares to reduce the FCL balance to approximately AUD\$25 million. NPF hold 19 percent interest in Steamships Trading. Believes that Steamships Trading stock at could be sold close to market value, i.e. \$3.20 per share. JF. Queried how long the fund needs to achieve sale of Collins and Leahy shares. JM. Indicated that the end of May 1999 should be sufficient time to achieve sale of the Collins and Leahy shares. TJ queried who would negotiate the Swires and other potential buyers of the Collins and Leahy stock. JM. Jimmy Maladina undertook to take on this responsibility with assistance from Paul Marshall. JM revealed the sale of Cue Energy shares will be deferred to 1/9/99 to coincide with a put option at AUD\$0.08 per share. Current market value, AUD\$0.04 per share. JM stated that Vengold shares are depressed at present due to (a) problems on Lihir Island with plant and (b) market perception that the company is too highly geared. The fund anticipates an appreciation in share price due to (a) Lihir plant problem has been resolved by Rio Tinto and (b) a refinancing package is being arranged. The fund may look to hold onto the Vengold shares to the end of the year. JM revealed that the fund is to retire the residual BSP facility, PNGK 2 million from the sale of K1 million Orogen Mineral shares. PM undertook to provide the bank with a written share divestment strategy update. NPF Tower. JM revealed that the PNG Harbours Board have approved the acquisition of 50 per cent interest in the NPF Tower. The PNG Harbours Board will assume K40 million of the PNGBC debt. The transaction will take

several weeks to bed down.

[3.19 pm] PM indicated that the fund would negotiate directly with the Pacific Finance Group should the PNG Harbours Board transaction fall through. JM stated that the fund is looking to borrow a further 2 million from the PNGBC to finance the fixtures and fittings for two floors of the NPF Tower to be occupied by the Mineral Resource department. NPF would on lend the funds to the Mineral Resource department at a commercial rate.

Political considerations. KM raised the bank's concern regarding the potential for political fall out on release to the public of the fund's 1998 results and queried how the fund had prepared for the scenario. JM revealed that the board has a sub-committee devoted to this area. Two committee members are union officials and they are charged with disseminating information gradually to the members and allaying member concerns. Their message to the members will be that the fund is endeavouring to reduce debt, reduce exposure to equities and build up cash reserves. The board are committed to disclosing the full extent of the fund's 1998 performance to the members prior to July 1999.

It is envisaged that the FCL facility will have been reduced to a level comfortable to the ANZ and the fund, say AUD\$25 million, and that the PNG Harbours Board will have assumed K40 million of the PNGBC liability prior to the release of the fund's 1998 results to the public.

PM mentioned that Deloitte's are still finalising the 1997 audit. Deloitte's have queried the treatment of the government loan sold to the Bank of Hawaii, i.e. Deloitte's are of the opinion that the profit on sale of the loans should have been spread over the 10 year loan term and not fully taken to profit in 1997. Deloitte's have also queried the appropriateness of equity accounting for the fund's interest in Collins and Leahy and Steamships Trading, i.e. Deloitte's believe that the treatment is not in the spirit of the guidelines given that the fund does not have a controlling interest in either company.

Breach of covenants. KM stated that the fund is in breach of negative pledge covenants, specifically interest cover covenant, and that the bank intends to formally reserve its rights by way of a letter to the fund.

[3.21 pm] Pricing.

THE CHAIRMAN: You know what that means, paragraph under the heading "Paul Marshall." It talked about Deloitte's and - - -

MR WARDLEY: Deloitte's and equity accounting, yes. What had happened in 1997, the financial - the draft financial statements as prepared by management had followed the concept of equity accounting for Collins and Leahy and Steamships. What that means is that rather than just bringing in dividends as income from those investments, because they perceived that they had a substantial proportion of shares, they could follow the accounting convention of effectively consolidating their share of those two companies into their accounts. So, they would - the would have - so, in respect to Collins and Leahy, which I think they had sort of 30 odd percent, they were taking 30 odd percent of their - of Collins and Leahy's profit for the year and Collins and Leahy's reserves. So, that ends up boosting NPF's reported profit and net assets. Now, equity accounting is an acceptable term and is an acceptable accounting policy where an investing company has technically, anywhere in excess of 20 percent of shares. But, there are certain criteria to be followed before one should equity account. And, one of them is whether or not the investee company has - sorry, the investor company has some control and that control can be recognised in a number of ways. For instance, board representation, influence in the board, influence in dividend policies, influence in management policies. There is a whole number or criteria to be looked at. I would certainly agree with Deloitte's comments that they did not have a controlling interest even though it was a substantial interest in Collins and Leahy and Steamships.

[3:23 pm] It was quite apparent that Swire's board and the Collins and Leahy other board members had the controlling interest. They called the shots. They determined what the dividend policy would be. They determined the strategies and the inference is that NPF even though holding a substantial amount of shares had little direct impact in what was happening to those two companies.

THE CHAIRMAN: So equity accounting was not appropriate?

MR WARDLEY: I would agree with Deloitte that equity accounting was not appropriate in these circumstances.

THE CHAIRMAN: I am saying if that is dismantled if you like, that form of accounting, what was the result?

MR WARDLEY: The result would be that the 1997 profits to be reported would come down substantially.

THE CHAIRMAN: Thank you.

MR WARDLEY: To continue with the quote. "Breach of covenants." No we have done that one. "Pricing. KM highlighted that the fund currently enjoys fine pricing of \$.150 per annum over costs of funds. Stated that pricing needs to reflect the perceived risk and compensate the bank for management time. Given the range of covenants, the bank is entitled to apply default interest of an additional 5 per cent. The bank will review pricing at the end of May 1999 in light of progress made towards divestment of Collins and Leahy shares.

Prudential guidelines. JF stated that prudential guidelines require the bank to reduce exposures to single counterparts to 40 per cent of capital base by 1/1/2000.

[3:25 pm] Any the exposure falling outside the guidelines after this date would necessitate a parental guarantee and that the additional cost of the parental guarantee would be passed onto those customers outside the prudential guidelines.

Outcome conclusion. (1) NPF to formally document updated equity divestment strategy to the bank. (2) Jimmy Maladina with assistance from Paul Marshall to pursue the sale of Collins and Leahy shareholding between now and 31/5/99. (3) Paul Marshall and Jimmy Maladina to provide MBB with a regular update regarding share divestment strategy and sale of 50 per cent equity in the NPF tower. (4) Further meeting to be held 31/05/99. (5) The bank to re-assess risk grade and pricing as at 31/05/99." A copy of this e-mail will be found in CD457 and will be tendered documents B1693 to 1695.

June 1999. In addition to this activity, we also note from ANZ diary notes what turns out to be a very significant internal ANZ e-mail dated 9 June, 1999 sent from Mr Jenkin to Mr Frazer. The e-mail stated: "Tait, I have read your latest diary note and the memos dated 26 and 28 May from Allens Arthur Robison. The opinion is not as we expected and we are potentially exposed with our current borrowings.

[3:27 pm] The imminent ARCM must address the question of basic or terminating limits and to that end I am aware of your off the record discussions with NPF which ostensibly gives me the impression we can expect some further ammotisation in the medium term. I would like this issue explored and clarified as part of your review. I am also aware it is unlikely a review will be completed prior to your departure - whilst I have diarised 30/6/99, I will take the matter up with Kirk, and your replacement at that time. Cheers." A copy of this e-mail can be found in commission B1696.

The e-mail was referring to a legal opinion obtained by ANZ from the legal firm Allens Arthur Robison dated 26 May 1999. A review of this legal opinion which can be found in commission document 42 reveals that on 19 April 1999 Mr Jock Frazer the senior credit manager of ANZ Bank in Port Moresby sought advice from Allens Arthur Robison Lawyers of Port Moresby in terms of a security held for a 53.7 million facility and to determine the borrowing powers of NPF and to confirm the facilities are within the relevant legislation. The advice is contained in a letter dated 26 May 1999, a copy of which was again provided by the bank to NPF and which is tendered B1697 - B1700.

THE CHAIRMAN: This is the advice I was inquiring about and I think I erroneously mentioned the firm Gadens. It was from Allens Arthur Robison apparently.

MR WARDLEY: Gadens has been referred to in this hearing or another - - -

THE CHAIRMAN: Earlier today I asked about the Gadens' advice on this point but it was Allens Arthur Robison I should have been referring to.

[3:30 pm] The letter states the opinion given on page 1 saying that in Allens Arthur Robinsons'

views, the NPF lacks power to borrow and then proceeds to state the reasons for that opinion review the NPF Act, the Trustees and Executors Act, the Public Finances (Management) Act 1995 and the early opinion of Messrs Carter Newell which they describe as being in their opinion incorrect and giving reasons. The implications of the lack of power and listed on page 5 of the letter and in short are:

(a) The contract is void and unenforceable and the bank would not recover principal interest or other amounts due under the contract.

(b) The principal sum advanced may but not interest and fees be rerecoverable by a quasi contractual remedy if that became necessary.

(c) If the Trustees and Executors Act applies, it is unlikely but possible the borrowing and security may be found illegal and in such case the bank would not be able to recover the principal sum either.

As we will see this advice and the course of action proposed became the driving factor in the bank's conduct as it studiously avoided giving NPF any hint of the problem of which the bank had become aware. Allens Arthur Robinson's opinion is important and therefore we will now read in full.

"Dear Jock, National Provident Fund Board of Trustees, NPF. Independent review of securities. We refer to your letter of 19 April 1999 and our meeting on 25 May 1999. You have asked us to conduct an independent review of the securities held by ANZ in respect of its AUD\$53.76 million facility provided to NPF and to determine the borrowing powers of NPF and confirm the facilities having made available in terms of relevant legislation.

[3.33 pm] This letter sets out our opinion about NPF's borrowing powers. We will advise you separately on the securities themselves.

Opinion.

(1) In our opinion, NPF lacks power to borrow. The reasons for this opinion and the implications are as follows; no express or implied power to borrow in the NPF Act.

(2) NPF is a corporation established under the National Provident Fund Act, the NPF Act. A statutory corporation such as NPF does not possess any inherent or implied powers or authorities. NPF's powers are limited to those conferred expressly or by implication by an act of the National Parliament.

(3) The NPF Act confers on NPF certain express powers on authorities. These include the power to acquire, hold and dispose of property. To sue and be sued in its corporate name and to administer the National Provident Fund established under the NPF Act in such a manner as is provided under the NPF Act and to perform such other functions as are required under the NPF Act.

(4) The express powers conferred on NPF under the NPF Act do not include a power to borrow. The question is then whether that power can be implied from the provisions of the NPF Act. For example, from NPF's general powers and function conferred by the NPF Act.

(5) The rules applicable to NPF made under the NPF Act impose strict limits and controls on the way in which the fund and monies belonging to the fund may be deposited, invested and disbursed. There is no mention in the rules of borrowing or meeting debt service or other obligations relating to borrowing.

(6) The NPF Act imposes an obligation on employers and employees to make contributions to the fund. However, the NPF Act does not otherwise provide for any other source of funds for NPF. The NPF Act and the rules prescribe the manner in which NPF is to administer the fund in terms of making deposits and investments, collecting contributions and paying out members.

[3.35 pm] (7) The NPF Act does not confer on NPF any general power or authority to do things which are incidental to its powers and functions conferred expressly under the NPF Act.

(8) Taking these factors into account, in our view it cannot be implied from the NPF Act that NPF has power to borrow since says there is no support for such an implication in any of the

provisions conferring powers and authorities on NPF. Further, it is hard to see how it is necessary as opposed to desirable that NPF should have power to borrow for it properly to perform its functions as prescribed in the NPF Act.

The other possible sources of a power to borrow. Trustees and Executors Act.

(9) The Trustees and Executors Act, the Trust Act, confers certain powers on trustees. The Trust Act applies to trusts created by an instrument which includes an Act of Parliament. In our view the fund would be likely to be regarded as a trust for the purposes of the Trust Act, even though this is not expressed in the NPF Act or the Rules.

The fact that NPF is known as the National Provident Fund board of trustees that NPF is stated to be the trustee of the fund and the nature of the fund itself are in our view strong indicators that the fund is a trust. Accordingly, we believe that the powers and limitations imposed on trustees under the Trust Act apply to NPF.

The Trust Act confers on the trustee of a trust a qualified power to borrow on the security of trust property. However, the prior sanction of the National Court is needed and the money raised maybe used only for very limited purposes. There is court authority which suggests that these limited purposes do not include the purpose of acquiring assets.

[3.37 pm] (11) We therefore doubt that this power will support NPF's borrowing from ANZ, given that the purpose of the facility was to fund the acquisition of securities. Indeed arguably, the Trust Act makes it illegal for the trustee of a trust to borrow money or give security over trust property other than in accordance with the power conferred by the act. If this is the case and the Trust Act applies to NPF, it may have been illegal for NPF to borrow from ANZ and to give ANZ security over NPF's assets.

Public Finances (Management) Act.

(12) Section 55 of the Public Finance (Management) Act, the PFM Act confers on a public body to which this act applies power with the consent of the minister to borrow money for its purposes from a person on such terms as are agreed between the public body and the person. Section 56 confers on such a body power with the consent of the minister to borrow for its purposes by overdraft within such limits as the minister approves.

(13) Public body is defined in the PFM Act. NPF is a public body under this definition.

(14) However, sections 55 and 56 fall within part V111 of the PFM Act. Section 48 of the PFM Act provides that nothing in part V111 applies to or in relation to a public body unless it is so provided by a law and then only to the extent provided by the law. There is an exception to this where a provision in part B111 itself is stated to apply to all public bodies despite the provisions of any other law.

(15) The NPF Act does not provide that part V111 of the PFM Act applies to NPF either wholly or to any extent at all. We are not aware of any other law which so provides. Accordingly, only those provisions in part V111 which are expressly stated to apply to all public bodies apply to NPF.

[3.59 pm] (16) Sections 55 and 56 of the NPF Act are not provisions which are stated to apply to all public bodies. They do not therefore apply to NPF and do not confer on NPF any power to borrow.

(17) Section 61 of the NPF Act is a provision which is stated to apply to all public bodies and therefore applies to NPF. Section 61 provides that a public body shall not, except with the approval of the minister enter into a contract involving the payment or receipt of an amount or a property to a value or both exceeding: (a) K100,000; or (b) in the case of a public body declared by the Head of State acting on advice by notice in the National Gazette to be a public body to which section 61(2)(b) of the NPF Act applies K500,000.

(18) Section 61 does not confer any general power on public bodies to enter into contracts within the prescribed limits. Instead, it merely imposes a general limit on the exercise by public bodies of their powers. It does not actually confer any power or authority. A public body which proposes to enter into a contract must have power conferred on it to do so from some other source. The exercise of such a power having been conferred elsewhere is limited by section 61.

(19) Accordingly section 61 cannot support the entry by NPF into a borrowing contract which NPF does not otherwise have power to enter into regardless whether the minister has given approval or whether NPF is declared to be a public body to which section 61(2)(b) of the PFM Act applies.

Other Sources.

(20) We are not aware of any other legislation which might be a source for NPF of power to borrow.

Carter Newell's Opinion.

(21) It follows from our comments above that we believe Carter Newell's opinion dated 10 September 1996 to be incorrect. In our view it is incorrect in a number of respects including those set out below.

(22) Carter Newell acknowledge in their opinion that section 55 of the NPF Act (the borrowing power) only applies to NPF if so provided in another law.

[3.41 pm] However they then take the view that because NPF was declared by the Head of State in the National Gazette to be a public body to which section 62(b) of the Public Finances (Management) Act 1986, which was replaced by the PFM Act, applied, it is a public body to which section 55 of the PFM Act applies. This is wrong, because (a) section 48 expressly requires that there be another law which makes the relevant provision of part V111 (here section 55) applicable. (b) The declaration in the National Gazette made NPF subject to a different and unrelated provision of an earlier act, the 1986 act, and (c) it is unlikely that the declaration in the National Gazette is a law for the purposes of section 48 of the PFM Act.

(23) Secondly, Carter Newell assumed that section 61 of the PFM Act which is stated to apply to all public bodies notwithstanding any other law is a separate head of power conferring power on public bodies to enter into contracts. This is incorrect. It imposes a requirement that ministerial consent be obtained before certain contracts are entered into. But, the public body still needs power under its constituent legislation to enter into the contract in the first place.

(23) Thirdly, on page 1 of the opinion, Carter Newell state that in the case of NPF there is no trust instrument as the board is created by statute.

[3.43 pm] However, the Trust Act referred to above defines instruments specifically to include an act of parliament. Having made this error, Carter Newell neglected to consider the Trust Act and whether it may be illegal for NPF to borrow under the Trust Act without the sanction of the National Court or at all.

Implications of NPF's lack of power to borrow

(25) Given that NPF lacks power to borrow, the contract between ANZ and NPF for NPF's loan facility is void and unenforceable. ANZ, therefore would not necessarily be able to sue NPF to recover principal interest or other amounts due by NPF to ANZ under the contract.

(26) However, this is not to say that money advanced to NPF is not recoverable. There are various quasi contractual remedies which, in our view, would be available to ANZ to recover monies advanced to NPF, such as an action for money had and received. ANZ would be able to recover only principal and not fees and interest if it became necessary to pursue such a remedy.

(27) Arguably, NPF's failure to comply with the Trust Act, i.e. by borrowing and giving security over its assets without the sanction of the National Court, would render the borrowing and giving of security illegal, in addition to the loan facility contract being void. If so, ANZ would not be able to recover principal either. This is an unlikely result but not an impossible one.

[3:45 pm] Courses of action.

(28) The only way to overcome NPF's lack of borrowing power would be to seek an amendment to the NPF Act or some legislative confirmation that section 55 of the PFM Act applies to NPF. However, to seek this would surely flag to NPF that there is a problem. In our view, the better course is to try to reduce the loan over time until the exposure is removed. In the interim, you should, if possible use repayments to offset firstly against interest and fees given the difficulty in

recovering these amounts if the facility agreement was subsequently found to be void. Please call either of us if you have any queries or wish to discuss any aspect of this letter."

July 1999.

NPF oblivious to this advice continued throughout July 1999 in its debt reduction strategy. ANZ diary notes record the following sales all retired to ANZ debt. Vengold 185,000 shares, 199,400 shares, 190,000 shares, 240,000 shares. Collins and Leahy, 8,223,179 shares for proceeds of AUD\$12,371,773. Loans rolled over for 30 days, (1) AUD\$4,206,009; (2) AUD\$1,427,647.

[3.47 pm] (3) AUD\$2,142,088. A copy of the relevant diary notes can be found in commission document 461 and will be tendered as documents B1701 to 1705.

On 29 and 30 July '99, NPF held its 119th board of trustee meeting. On 30 July '99 the board was provided with an update on the fund's progress on its debt reduction strategy. The minutes of this meeting which can be found in commission document 51 and which will be tendered as documents B1706 summarised the position as follows.

9.1 Debt. "The debt analyst set out for the board the fund's debt position: (1) AUD\$53 million with ANZ as at 30 April now at AUD\$24 million; (2) PNGBC Tower loan at K60 million; (3) K4.5 million overdraft with PNGBC. Total debt as at 30 April '99 stood out at K145 million. It is anticipated that as at the end of August 1999 total debt would be reduced to K99 million. The above debt position was noted by the board.

Commendation. The chairman recorded on behalf of the board its commendation to members of the investment team and in particular Mr Rod Mitchell for their efforts in addressing the fund's outstanding debt position.

[3.49 pm] There was circulated to all board members a letter from the ANZ Bank, also commending Mr Rod Mitchell and his team for their cooperation and effort in the timely submission of information and statistics required as part of the fund's borrowing obligations."

August 1999.

Through August and September 1999 the following sell down in investments continued and the proceeds of which were made against ANZ debt. Vengold; 365,000 shares or AUD\$28,256. 489,000 shares, AUD\$37,856. 362,000 shares, AUD\$24,384. 500,000 shares, AUD\$34,772. Macmin; 863,800 shares, proceeds AUD\$34,749. Copies of the relevant diary notes can be found in commission document 461 and will be tendered as document B1707 to 1709.

By 11 August 1999, we note from ANZ diary note that NPF had submitted its management accounts to 30 June 1999 which rendered a loss before tax, 68.3 million. A copy of the diary note dated 11 August 1999 can be found in commission document 461 and will be tendered as documents B1710.

In August and September 1999, due to the need to continually review progress on its debt reduction strategy and also because of internal clashes within the board itself a number of board meetings were held. Three meetings were held, two of which were special. A review of the supporting board papers for these meetings reveals that in contrast to earlier years 1997 to May 1999, the reports provided to the board by management were comprehensive.

[3.51 pm] Nothing substantial was reported in these meetings other than at the special meeting 5 August 1999 recorded that NPF's debt was anticipated to be down to approximately K20 million. This will be tendered as B1711.

In September 1999 ANZ prepared an annual review updated credit memorandum. A copy of this can be found in commission document 461 and a copy will be tendered as document B1712 to 1734.

The credit memorandum and review memorandum provides us with a good summary of the facility and also evidence of ANZ's approach to NPF subsequent its obtaining advice from Allens Arthur Robinson of NPF's apparent lack of power to borrow.

The credit memorandum summarised developments since the last review as follows. "AUD FCL has been reduced from 53.67 million to 24.335 million from partial disposal of share portfolio

listed on the ASX since January 1999. This is part of a purposeful strategy undertaken by the management board of NPF in reducing its high level of indebtedness - a copy of ministerial approval of same held - resultant from its past poorly conceived investment strategy. Indeed it is advised that debt with all financial institutions will be fully repaid by 31/12/2000.

[3.53 pm] ANZ is to seek parameters for clearance by 30/6/2000, in line with legislation shortly to be introduced which will revoke the fund's ability to borrow. ANZ FCL facility- - -

THE CHAIRMAN: But then what is that comment?

MR WARDLEY: Yes, I am not sure about that one.

THE CHAIRMAN: It is already there. I have not heard of such legislation.

MR WARDLEY: Chairman, the only thing which I can possibly allude to is, the ANZ is aware that the new Bank of Papua New Guinea guidelines are coming into play whereby they would than be restricted as to how much they can lend to any one customer but that certainly is not in the context of what the credit memo is saying.

THE CHAIRMAN: It is not saying that.

MR WARDLEY: No. ANZ FCL facility to be reduced to AUD\$10 million by the end of December 1999, with efforts to be pursued to ensure the remaining debt be cleared in full over the following six months. Repayment is currently dependent upon liquidation of shares listed on the ASX although residual stocks held tend to comprise lower performing assets which may take some time to realise. This aspect is elaborated upon later in these advices. Advances of 14.3 million provided by Bank of South Pacific have been repaid from cash reserves. The NPF Tower was completed within time frames although in view of currency devaluation has been at a significant increase in cost. To-date only modest success has been obtained in securing tenants (naming rights have been sold to Deloitte Touche Tohmatsu) and it is unlikely the tenancy target of 60 percent by 31/12/99 will be achieved unless material discounting of rentals occur.

[3.55 pm] Cost of fit outs for tenancies has yet to be expensed. Debt currently provided by PNGBC is set at K55 million. Again, NPF are committed to the sale of this asset although a suitable purchaser has not been located at this time.

Previous finance and investment manager, Noel Wright, has been dismissed for non performance and replaced by Rod Mitchell in May 1999 following a review of the fund's investments by Price Waterhouse Coopers. Rod Mitchell is considered well qualified for the position given his past background in the fund's management sector in Australia. Mr Mitchell has set about implementing improved financial control systems and will culminate in the more timely production of data. His brief also includes the development of strategic and risk management plans which over the ensuing period should enable improved control and investment strategy. Indicative plans for re-structure, re-positioning have been discussed and we address under prospective trading commentary later in these advices. The bank considers Mr Mitchell to be a very - to be a key individual in meeting these objectives and a sound working relationship has been established in regular appraising the bank of progress. The fund has announced to the public that substantial losses will be made in 1998, 1999. The extent of these losses has not been revealed, although negative comments have been circulated in the news media in recent times.

[3.56 pm] Some oil and mining employees, the country's largest employment sector have voiced strong concern. Once formally announced, it is likely that this will have material repercussions given the nature of NPF's activities. Provision of audited accounts to 31/12/97 with accounts as at 31/12/98 now due 30/9/99. Inordinate delay is reflective of previous poor reporting structure. Monthly management reporting has been provided and evidences material deterioration in financial performance condition in line with falling share investment values, increased interest costs and reduction in core revenues. This has resulted in further breaches of financial covenants as per our negative pledge, (bank has reserved its rights). In line with high debt volume and interest rates currently cash flow is under some pressure and could be vulnerable if material debt reduction does not occur in the short/medium term.

In view of the above adverse features, account has been further down graded from 6 to 7."

THE CHAIRMAN: Very good. It is a sad picture but thank you and that I think is the time to

adjourn for today. We will not be resuming here tomorrow, we will be resuming at the Islander Hotel in the VIII Bells conference venue, continuing the public hearing in the form of a seminar. And we will be resuming on Thursday I think here rather than Wednesday. All right, thank you very much.

AT 3.58 PM, THE INQUIRY WAS ADJOURNED UNTIL THURSDAY 17 AUGUST 2000.

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Morauta House, Waigani, P.O. BOX 639, WAIGANI, Papua New Guinea  
Telephone: (675) 327 6525 Facsimile: (675) 323 3943  
Parliament Office, National Parliament House, WAIGANI, N.C.D., Papua New Guinea.  
Telephone: (675) 327 7316, (675) 327 7317 Facsimile: (675) 327 7490  
Email: [pmsmedia@pm.gov.pg](mailto:pmsmedia@pm.gov.pg)