



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Consideration of Budget Estimates

THURSDAY, 6 JUNE 2002

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SENATE
ECONOMICS LEGISLATION COMMITTEE
Thursday, 6 June 2002

Members: Senator Brandis (*Chair*), Senator Jacinta Collins (*Deputy Chair*), Senators Chapman, Murray, Schacht and Watson

Senators in attendance: Senators Allison, Brandis, Calvert, Jacinta Collins, Conroy, Cook, Mason, Schacht, Sherry, Tierney and Watson

Committee met at 9.07 a.m.

TREASURY PORTFOLIO

Consideration resumed from 5 June 2002.

In Attendance

Senator Ian Campbell, Parliamentary Secretary to the Treasurer

Department of the Treasury

Mr Roger Brake, General Manager, Retirement and Personal Income Division

Mr Colin Brown, Manager, Costings and Quantitative Analysis Unit

Mr Russell Campbell, Manager, Financial Services Regulation Unit

Mr Joe Castellino, Intergovernment Relations Unit

Mr John Coleman, Chief Financial Officer, Accounting and Financial Management Unit

Mr Blair Comley, General Manager, Macroeconomic Policy

Ms Lynne Curren, Specialist Adviser, Financial Institutions Division

Mr Graeme Davis, General Manager, Strategy and Coordination Unit

Mr Damien Dunn, Manager, Economic Conditions Division

Ms Laurene Edsor, General Manager, Commonwealth State Relations Division

Mr Murray Edwards, General Manager, Board of Taxation

Mr Ron Foster, General Manager, Indirect Tax Division

Mr Steve French, General Manager, Financial Institutions Division

Ms Bernadette Welch, Manager, HIH Assistance Scheme Project, Financial Institutions Division

Mr Phil Gallagher, Manager, Retirement and Income Modelling Unit

Mr Peter Greagg, Manager, Revenue Analysis Unit

Mr Godwin Grech, Specialist Adviser, Financial Institutions Division

Dr Paul Grimes, General Manager, Budget Policy Division

Dr Jim Hagan, General Manager, Foreign Investment Division

Mr Rob Heferen, General Manager, Corporate Governance and Accounting Policy Division

Dr Ken Henry, Secretary

Mr John Hill, General Manager, Consumer Affairs Division

Ms Natalie Horvat, Manager, Strategic Policy Unit

Mr Stewart Jones, General Manager, Structural Reform Division

Mr Bill Keown, HIH Royal Commission Task Force

Mr Chris Legg, General Manager, International Economy Division

Mr Paul Lindwall, Specialist Adviser, Domestic Economy Division
Mr Peter Martin, Australian Government Actuary
Mr David Martine, General Manager, Business Entities and International Tax Division
Mr Andrew Matters, Forecasting Unit
Mr Stephen Miners, Manager, International Monetary Fund Unit
Ms Maryanne Mrakovcic, General Manager, International Finance Division
Mr Richard Murray, Chief Adviser, Corporate Strategy
Dr Paul O'Mara, General Manager, Domestic Economy Division
Dr Martin Parkinson, Executive Director, Economic Group
Mr Wayne Poels, International Economic Conditions and Outlook Unit
Mr Nigel Ray, Executive Director, Markets Group
Mr Ian Robinson, General Manager, Corporate Services Division
Mr Jason Russo, Economic Conditions Division
Mr Iain Scott, Manager, Fiscal Policy Unit
Mr Greg Smith, Executive Director, Budget Group
Mr Nick Stoney, Manager, Forecasting Unit
Mr David Tune, General Manager, Business Income and Industry Policy Division
Mr David Turvey, Specialist Adviser, Fiscal Policy Unit
Ms Sue Vroombout, General Manager, Financial Markets Division

Australian Accounting Standards Board

Mr Keith Alfredson, Chairman

Australian Bureau of Statistics

Mr Rob Edwards, Acting Australian Statistician
Mr Peter Harper, Acting Deputy Australian Statistician
Mr Graeme Hope, First Assistant Statistician, Corporate Services Division
Ms Marion McEwin, Assistant Statistician, Policy Secretariat Branch

Australian Competition and Consumer Commission

Mr Robert Antich, General Manager, Compliance Strategies Branch
Mr Brian Cassidy, Chief Executive Officer
Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division
Ms Lin Enright, Director, Public Relations
Mr Tim Grimwade, Director, Adjudication Branch
Mr Brian Kelleher, Project Manager
Mr Gordon Lister, Management Accountant
Ms Helen Lu, General Manager, Corporate Management Branch
Ms Marlene McClelland, Director, Finance and Services
Ms Karen McKernan, Project Manager
Mr Mark Pearson, General Manager, Mergers and Asset Sales Branch
Mr David Smith, Executive General Manager, Compliance Division

Australian Prudential Regulation Authority

Mr Greg Brunner, General Manager, Policy Research and Consulting Division
Mr Tom Karp, Executive General Manager, Diversified Institutions Division
Mr Les Phelps, Executive General Manager, Specialised Institutions Division
Dr Darryl Roberts, General Manager, Specialised Institutions Division

Mr Graeme Thompson, Chief Executive Officer

Australian Securities and Investments Commission

Ms Sharman Grant, Assistant Director, Regulatory Operations

Ms Kate Harvey, Director, Public Affairs

Mr Carlos Iglesias, Executive Director, Infrastructure

Mr Ian Johnston, Executive Director, Financial Services Regulation

Mr Peter Kell, Executive Director, Consumer Protection

Mr David Knott, Chairman

Mr Andrew Larcos, Government Relations Adviser

Mr Ian Mackintosh, Chief Accountant

Ms Jan Redfern, Deputy Executive Director Enforcement

Mr Malcolm Rodgers, Executive Director, Policy and Markets Regulation

Mr Peter Wood, Executive Director, Enforcement

Australian Office of Financial Management

Mr Michael Allen, Chief Executive Officer

Mr Paul Ferris

Mr Andrew Johnson

Ms Erin Martin

Mr Peter McCray, Deputy Chief Officer

Mr Pat Roccosta, Chief Financial Officer

Mr Craig Thornburn

Australian Taxation Office

Mr Leo Bator, Deputy Commissioner, Superannuation

Mr Michael Carmody, Commissioner

Mr Paul Duffus, Deputy Commissioner, Excise

Mr Kevin Fitzpatrick, First Assistant Commissioner, Aggressive Tax Planning

Ms Jennie Granger, Deputy Commissioner, Personal Tax

Ms Erin Holland, Deputy Commissioner, Client Account Management

Mr Neil Mann, Deputy Commissioner, Small Business

Ms Donna Moody, Chief Finance Officer

Mr Barrie Russell, Deputy Commissioner, GST

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director

Financial Reporting Council

Mr Mike Kooymans

Mr Jeffrey Lucy, Chairman

National Competition Council

Ms Michelle Groves

Mr Mick Shadwick

Productivity Commission

Mr Robert Kerr, Head of Office

Mr Garth Pitkethly, First Assistant Commissioner

Takeovers Panel

Mr Nigel Morris, General Manager

CHAIR—Good morning, ladies and gentlemen. I call the committee to order. Today the committee will continue its examination of the Treasury portfolio estimates, commencing with the Australian Office of Financial Management. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has a discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise. However, I also direct to the attention of the witnesses resolutions 9 and 10 agreed to by the Senate on 25 February 1998 concerning the conduct of hearings by Senate committees. Resolution 9 provides:

A chairman of a committee shall take care to ensure that all questions put to witnesses are relevant to the committee's inquiry and that the information sought by those questions is necessary for the purpose of that inquiry. Where a member of a committee requests discussion of a ruling of the chairman on this matter, the committee shall deliberate in private session and determine whether any question which is the subject of the ruling is to be permitted.

Resolution 10 provides:

Where a witness objects to answering any question put to the witness on any ground, including the ground that the question is not relevant or that the answer may incriminate the witness, the witness shall be invited to state the ground upon which objection to answering the question is taken. Unless the committee determines immediately that the question should not be pressed, the committee shall then consider in private session whether it will insist upon an answer to the question, having regard to the relevance of the question to the committee's inquiry and the importance to the inquiry of the information sought by the question. If the committee determines that it requires an answer to the question, the witness shall be informed of that determination and the reasons for the determination, and shall be required to answer the question only in private session unless the committee determines that it is essential to the committee's inquiry that the question be answered in public session. Where a witness declines to answer a question to which a committee has required an answer, the committee shall report the facts to the Senate.

I also remind officers that an officer shall not be asked to give an opinion on matters of policy and should be given a reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. Witnesses should note that the evidence given to the committee is protected by parliamentary privilege. I also remind you that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate.

[9.10 a.m.]

Australian Office of Financial Management

CHAIR—I welcome officers of the Australian Office of Financial Management. Dr Parkinson, do you wish to make an opening statement?

Dr Parkinson—No, thank you.

CHAIR—Thank you. Senator Conroy?

Senator CONROY—I would like to discuss the repayment of debt over the forward years as reported in Budget Paper No. 1, table B2 on page 2-17, and AOFM's agency budget statements, table 3.8 on page 109. In Budget Paper No. 1 2002-03, table B2 on page 2-17, equity assets are projected to decline from \$51.4 billion in 2001-02 to just \$14.4 billion in 2005-06, a 72 per cent decline. Dr Watt from DOFA confirmed last week that this reflected asset sales, including the sale of Telstra. Are you familiar with these projections?

Mr Allen—I am familiar with those numbers in the sense that I am reading the same numbers that you are. Obviously we are not involved in the—

Senator CONROY—I was not suggesting that you worked on them.

Mr Allen—No, but we see the table.

Senator CONROY—Also table B2 shows that government securities fall by \$64 billion to just under \$2.8 billion. Are you familiar with those projections?

Mr Allen—That is right, yes.

Senator CONROY—A similar reduction in debt is also reflected in your own AOFM agency budget statement in table 38 on page 109, where Commonwealth securities are projected to fall from \$64.1 billion in 2001-02 to \$2.3 billion in 2005-06. Is that correct?

Mr Allen—That is right, yes.

Senator CONROY—So, according to the budget papers, by 2005-06 there will be less than \$2.8 billion of government securities on issue, of which AOFM will manage \$2.3 billion. Is that right?

Mr Allen—I think there that it may be best to draw your attention to one of the notes in the accounts. If you go to note 11 on page 12-12 of Budget Paper No. 1—

Senator CONROY—Yes. Do you want to draw my attention to anything in particular there?

Mr Allen—With reference to the question as to what would be the level of government securities that we would be managing in the 2005-06 financial year, as we point out in note 11—and this has been practised for a number of years now—in the balance sheet, and effectively in our numbering, we net off the holding of financial assets that may or may not be assumed in the numbers moving forward. So either in table B2 or in our PBS balance sheet you will note that obviously government securities decline to that \$2.3 billion level in 2005-06, but that is a consequence more of the treatment that is outlined in note 11 in that we net off the two.

Dr Parkinson—The point of that is that you cannot draw any conclusion about the amount of Commonwealth government securities on issue from that table. All that is telling you is what we think will be the net impact of gross Commonwealth government securities on issue less whatever other asset holdings the Commonwealth may have at that stage.

Senator CONROY—You may have been anticipating some of my questions, so I am not quite sure whether that is why you wanted to make that point. I will keep wandering along and we will see whether you have anticipated where I am going. In his post-budget address to the Press Club on 16 May, the Treasurer said that asset sales would allow the Commonwealth to completely retire all of its debt. Are you familiar with that statement?

Mr Allen—Not that precise statement, but certainly comments to that effect.

Senator CONROY—I can give you the clipping if you like. I am not trying to verbal you. The headline was ‘Telstra sale will kill debt’.

Mr Allen—Yes.

Dr Parkinson—I think we understand that, and that is a reference to net Commonwealth debt.

Senator CONROY—So is the Treasurer planning to almost eradicate the government bond market?

Mr Allen—I think you should look at the commitment that is provided as part of Budget Paper No. 1 in statement 7 on page 7-4. Again, just drawing your attention to a couple of the specific paragraphs—and this is a commitment that has been made in previous years—the strategy has been aimed at maintaining the length and the efficiency of the yield curve and maintaining liquidity in key benchmark stocks. So again linking that back to what we have outlined in note 11, for a range of reasons we have not provided any specific details with respect to what that particular level of stock outstandings would be. But the intention is as highlighted in that paragraph: we are maintaining the liquidity of the existing benchmark lines notwithstanding that decline in net debt that is forecast over the budget period.

Senator CONROY—Thank you. How do you anticipate financial markets will price risk in the absence of a government yield curve and, hence, a risk free rate of return?

Dr Parkinson—Is this a hypothetical question?

Senator CONROY—No, it is based on the budget papers actually. It is a direct consequence of the projection in the government papers actually.

Dr Parkinson—I am sorry—

Senator CONROY—If you are saying that the government's position is hypothetical, I will happily accept that that is the case.

Dr Parkinson—I am sorry, but I made a comment a moment ago that you cannot read anything into the figures in the budget paper about gross Commonwealth government securities on issue. It would seem to me that you are asking a hypothetical question.

Senator CONROY—I am asking about a consequence of government policy.

Dr Parkinson—No, you are not asking a question about a consequence of government policy because there is no government policy that says that the government is going to take gross debt on issue to zero. What you are looking at is a figure that shows net debt, which is gross Commonwealth government securities on issue less asset holdings. If asset holdings were zero, then gross Commonwealth government securities on issue could be close to \$2 billion. It could be, on the other hand, that Commonwealth government securities on issue remain broadly unchanged from today but financial assets should keep—

Senator CONROY—It could be that the earth is flat, but what we have here is a set of facts and projections that are not hypothetical; they are statements by the government.

Dr Parkinson—Senator, I am sorry; I do not agree that those things are facts.

Senator CONROY—Can I read anything into the Treasurer's comments?

Dr Parkinson—No more than the fact that net debt on issue has declined in recent years more rapidly than have Commonwealth government securities on issue.

Senator CONROY—Yesterday I think Dr O'Mara was sitting next to you and he would frequently make the statement, 'If all other things were equal and this one parameter happened.' Dr Parkinson, I am holding everything else equal and this is one parameter. So I am looking for the implications that flow from this one policy change, assuming all other things are equal. Yes, you can make the argument if you want that a million other things could happen—the government could have a policy and a million other things may affect it. But I am holding everything else equal.

Dr Parkinson—I draw your attention to the very top of page 7-4, where it states:

The reduction in Commonwealth net debt has raised questions by some market participants about the future viability of the CGS market. The Government acknowledges these concerns and is carefully considering them, taking the views of key stakeholders into account.

While the Government considers these issues, it will continue the approach to debt management adopted in recent years. This strategy has been aimed at maintaining the length and efficiency of the yield curve and maintaining liquidity in key benchmark stocks.

So as a hypothetical—

Senator CONROY—No. Until the government have a policy otherwise, it is not hypothetical. The government have to come up with a policy response to this. That is what I am trying to ask a question about, Dr Parkinson. You are actually trying to argue that what the Treasurer said in his speech and what is actually written there is not the case. There needs to be a policy response to solve this issue.

Dr Parkinson—No, Senator, I am sorry; you are confusing gross debt on issue and net debt. If I have \$100 billion of gross debt on issue and I have \$50 billion of assets, I still have \$50 billion of net debt.

Senator CONROY—Thank you for that, Dr Parkinson. Have there been any discussions with financial or other institutions, including super fund managers and insurance companies, about plans to deal with this?

Dr Parkinson—The approach that the government may take is under deliberation at the moment. I will just refer you back to the comment in the paper. It has acknowledged the concerns and is intending to take the views of key stakeholders into account. The exact mechanics of how those key stakeholders' views are taken into account is still to be decided, as is a definition of who are key stakeholders. At the moment there has been quite a lot of comment from particular people in financial markets, as you would expect, because it is their livelihood that is at stake.

Senator CONROY—That is just where I was going. I was not trying to create a note of conspiracy over in a different corner; I was actually just coming down to asking about these very issues. As you said, there have been plenty of responses about this and, as you say, it involves their livelihood, so they are loud.

Dr Parkinson—From one segment of what we might describe as key stakeholders.

Senator CONROY—I accept that. We need a policy position to avoid this but, in the absence of a government bond market, what will investors such as retirees or their fund managers buy if they want a low risk, liquid, income generating security?

Dr Parkinson—We have not looked at that issue in the Australian context. All I can do is point to comments by the Chairman of the United States Federal Reserve, Alan Greenspan, a couple of years ago, I think it was, when the US looked like it was rapidly heading for zero net debt. He was quite confident that either markets would generate alternative instruments or people could use a range of semi-government instruments that have very similar risk characteristics.

Senator CONROY—Are they riskier? By definition, there has to be a greater margin of risk.

Mr Allen—Again, it depends on the range of securities that you are talking about. Obviously, in terms of state government versus Commonwealth government public sector securities, in pure absolute credit risk terms there is perhaps a marginal difference. But in

terms of market pricing, there may be other factors which contribute to the differential in yield—it may be due to liquidity and the like. Regarding private sector assets, there are a range of different rates of return, depending on the underlying credit quality, but it is a risk-return trade-off that drives that outcome.

Mr Comley—The other thing—and Mr Allen may want to comment on this—is that the decision for something like a super fund will not be whether they take a government bond in isolation versus another thing that may look slightly riskier in isolation; it will be the portfolio they construct.

Senator CONROY—Some HIH bonds, perhaps?

Mr Comley—I am not going to comment on a particular bond. I think we are all familiar with the fact that diversification means that the portfolio risk can be a different thing from the risk of a particular individual asset. You should not jump to the conclusion that—

Senator CONROY—Sure. Let us not pretend that government bonds are the safest and least risky of assets to hold. You were having a chat with me about gross, net and all the rest of it, but what does the Treasurer mean when he says that he is going to retire all debt?

Dr Parkinson—You would have to ask the Treasurer, but my interpretation is that he is talking about net debt.

Senator CONROY—Thank you for that. I am sure there are a few people out there who are very pleased to hear you say that. The reduction in government securities does have a significant impact on interest expense in the forward years.

Dr Parkinson—Yes, as I understand it.

Senator CONROY—Where is it reflected in your agency's budget statement? Is it on page 108, where the interest and financing costs are projected to fall from \$6.9 billion in 2001-02 to \$4.1 billion in 2005-06?

Mr Allen—That is correct.

Senator CONROY—Is that also reflected in a reduction in other interest expenses in Budget Paper No. 1 on page 2-16?

Mr Allen—That is more problematic in the sense that obviously we are not responsible for putting together the papers in Budget Paper No. 1, but it is reasonable to assume that our numbers flow through into that statement.

Senator CONROY—I am learning about these budget papers and the tables as I go. Such a reduction in interest expenses would contribute to a lower deficit or higher surplus in the out years, would it not?

Dr Parkinson—By definition; it is an area of expenditure that is being reduced.

Senator CONROY—If it is being reduced in this case, it would improve the bottom line by \$2.8 billion, would it not?

Dr Parkinson—What is that relative to?

Senator CONROY—Not having done it, yet.

Dr Parkinson—Yes, to not having done it.

Senator CONROY—By eradicating the bond market the government has improved its budget position by \$2.8 billion, is that right?

Dr Parkinson—Sorry, Senator—

Senator CONROY—Sorry, by reducing it: ‘eradicating’ might be too strong a word.

Dr Parkinson—We can bash heads on this point all morning, if we need to. There is no presumption that the bond market is going to be eradicated. As I have explained a number of times now, it is a reference to net debt. Net debt can be zero with \$50 billion of government securities on issue and \$50 billion worth of assets.

Senator CONROY—Do you think you would still have that saving?

Dr Parkinson—It would depend on the rate of return you got in the assets, but a reasonable presumption is yes.

Senator CONROY—It would depend on a couple of things.

Mr Allen—The rate of change in the government securities outline is not necessarily the issue in the sense that, as we indicated through our portfolio budget statements, we net off those two numbers. If you are looking at changes in the interest expense or interest revenue, you have to take into account changes to the underlying budget position as well. Just drawing an immediate link between a decline in government securities would lead you to a particular impact on interest expense. Even if you look at it on the basis of netting revenue and expense, that issue is going to be more subject to other changes within the budget, not due to a change in the actual level of government securities.

Senator CONROY—Dr Henry seems to have a different view from the Treasurer and the budget papers. Speaking on the future of the bond market in Sydney on 22 May, he said:

The government has indicated that it is thinking about these issues, considering those issues, and will in due course be informing the market of how it proposes to address the issues that have been raised.

Has AOFM been involved in any of these considerations?

Mr Allen—As Dr Parkinson has just outlined, the government has noted its intention to engage in broader consultation with respect to this issue, again with respect to the medium to longer term outlook, particularly in the context of some of the commentary that has been made in the public domain by some financial market participants. As to the question you ask with respect to the AOFM’s involvement in that process, our focus is on debt management issues, particularly with respect to risk management. There is obviously an overlap with Treasury with respect to matters of policy, and we contribute to that debate.

Senator CONROY—I will take that as a yes.

Mr Allen—Yes.

Mr Comley—The premise of your question is a difference of view between the secretary, the Treasury and the Treasurer on this matter. From that quote, and certainly from my understanding, there is no difference of view on this point.

Senator CONROY—I will happily accept your acknowledgment. Would my famous HIH bond be as liquid as a government bond?

Dr O’Mara—Not at the moment.

Senator CONROY—By definition government bonds are the most liquid, right? Would a government bond be least risk and most liquid? And anything that moves up the scale has to be a little bit less of both by definition—is that fair?

Mr Comley—I would not say ‘by definition’. I would say that at the moment in, for example, the Australian market, it is true to say that Commonwealth government securities are the most liquid and lowest risk securities.

Senator CONROY—In your experience, has that ever not been the case?

Mr Allen—In terms of liquidity, not necessarily. There have been low levels of government bond outstandings, particularly in the late eighties and early nineties. It think it is fair to say that there was probably more liquidity away from the government bond market. People may dispute that statement at the margin. The government bond is certainly in it from a risk perceptible in Australia, but this is not always the case. Certainly in Australia it is a low-risk investment, but liquidity is a different issue and that can change over time from one sector to another.

Senator CONROY—Demand was a bit lower back then, though. Super funds were not really around in the way they are now.

Mr Allen—No, I think, having been involved with the financial markets at that time, there was quite substantive turnover in non-Commonwealth government securities at the time. The markets were evolving and there were fairly high levels of turnover in the marketplace. Futures markets were active.

Senator CONROY—Who else has been involved in these consultations and considerations that Dr Henry is referring to?

Dr Henry—As I said, the manner in which these consultations will occur is a matter that is before the Treasurer at the moment.

Senator CONROY—Is the AOFM Advisory Board considering the issues as well?

Dr Parkinson—The AOFM Advisory Board by its nature will have an interest in the issues, but it is ultimately a matter of policy, not operational aspects. But, to the extent that the AOFM Advisory Board has a number of people with experience in financial markets, it is a useful source of expertise.

Senator CONROY—I would like to kick around what the potential options are. I am not asking you to go to your policy advice; I am just asking what the general policy options are. Is one of the options that the government would consider purchasing new assets?

Mr Comley—Perhaps I can answer that question. Essentially there are two broad classes of options. One is to not purchase assets and let your gross debt run-down match your net run-down. That is not the current government policy, as I think we have discussed. The second option is to purchase assets. Then, if you purchase assets, the amount of assets you purchase would be determined by the size of the bond market that you want to maintain. Then the question would become two questions. The first is what classes of asset would you choose; the second would be, if you like, the governance arrangements you would put around the holding of those assets.

Senator CONROY—I am sure you are anticipating my next questions. Perhaps I can throw them in so you can expand as you are going. The government is possibly considering purchasing new assets with the proceeds of asset sales rather than using the proceeds to pay down debt.

Mr Comley—I would not say the government is—

Senator CONROY—The debt is coming down because they are selling an asset, so they are selling an asset to buy an asset.

Mr Comley—One of the options in this consideration would be whether you purchase assets. That is in a sense a necessary consequence of maintaining—

Senator CONROY—Are you saying that that is not the government policy at the moment?

Mr Comley—No, that is made clear in the budget papers. What the government is saying is that, noting the concerns about the bond market, the government will consult to determine the best option forward, and a necessary consequence of maintaining the current fiscal strategy and maintaining a bond market, say, around the current levels or at any particular level would be the accumulation of assets.

Senator CONROY—Is there consideration of what sorts of assets they would be? Would they be financial or non-financial?

Dr Parkinson—I think you are jumping way—

Senator CONROY—I am just putting one of the options. I am not asking you to—

Dr Parkinson—No. I think you are jumping way too far forward. The threshold issue has to be what are the benefits and costs of having a CGS market. Then, if you have decided that the benefits of having a CGS market warrant keeping the market, then the question comes—

Senator CONROY—What do we have to do to achieve that?

Dr Parkinson—what do you actually do. Then you have a whole series of cascading questions which are way ahead of where I think anybody is at at the moment. It goes to things, as Mr Comley said, like governance arrangements.

Senator CONROY—Tell me: what sorts of arrangements do you think would be necessary in the circumstance?

Dr Parkinson—No, I cannot do that because we have not got that far along in the process. The budget papers are quite clear that we have heard people's concerns and we are going to start consulting. Let me make maybe a fairly blunt statement.

Senator CONROY—As opposed to the ones you have been making so far?

Dr Parkinson—I am trying to be as polite as usual.

CHAIR—I thought you were about to say, 'as polite as you'.

Dr Parkinson—Senator Conroy and I have known one another for many years. I would not go that far. The views that are expressed by financial market participants may well be diametrically opposed to the views expressed by, for example, the Australian Shareholders Association. I have absolutely no idea what the ASA's views might be but, from a fixed interest dealer's perspective, he or she may stop at the point of saying, 'We need a Commonwealth government securities market because that's my livelihood.' The Shareholders Association may well say, 'We don't want the Commonwealth government traipsing around in Australia's equity markets with a portfolio of \$20 billion, \$30 billion, \$40 billion or \$50 billion.'

A whole variety of issues are raised which are really quite complex and which are going to have to be considered quite carefully, which is one of the reasons why we have not rushed into this. Indeed, one of the things that I think is interesting is that in meetings I have had with

financial market participants overseas there is no sense that they are looking for answers from us yet. What they have been interested in is the fact that we have the issue on the radar screen and we are going to engage in a consultation process.

Senator CONROY—I am just asking about the whole issue. I agree it is an issue, and that is why I am seeking to have a discussion about it. Mr Comley mentioned that there were options about the sorts of assets. What would the options be?

Mr Comley—In a sense, it is like any person who is accumulating assets. You can think about a whole spectrum of assets and, largely, your risk return preference would determine what set of assets you may want to accumulate. I do not think this decision is necessarily that different from the decision faced by anyone deciding to accumulate assets. I suppose at one end in a spectrum you might start with very low risk government or semi-government bonds. You might move to equities somewhere along that line, and you would have to make a decision about whether you were going to restrict your activities to, for example, Australian assets or overseas assets, and then you would have to make, presumably, a subsidiary decision if one moved into overseas assets about whether you were prepared to take an open foreign currency position or not. But, in a sense, it is like anyone entering into a portfolio of assets: those are the sorts of decisions that would need to be made.

Senator CONROY—That is very helpful, thank you, Mr Comley. Again you have anticipated my questions. Some of the options would be equities, and foreign versus Australian would be a legitimate argument, particularly in terms of governance and those sorts of issues. But then what flows from there is that you have the currency exposure question.

Mr Comley—Again I do not want to get too far ahead here. The question of what portfolio you might accumulate on the hypothetical situation that you were accumulating an asset portfolio would also depend on things like the size of the portfolio.

Senator CONROY—Sure.

Mr Comley—When you are thinking about the economic consequences of the portfolio, probably, like any very large fund manager, the larger your portfolio the more you may be required to go on to a broader range of assets because you may be more likely to affect the prices of the assets that you go into if you restrict yourself to a subset.

Senator CONROY—If you did buy foreign assets—you mentioned the currency exchange rate—would you hedge in that circumstance, do you think?

Mr Comley—Can I just answer the question in a slightly different way?

Dr Parkinson—I think we are getting way beyond the realm of an area that I feel comfortable with. We are speculating here about possible decisions that you might take in the event that the government decided to undertake a particular type of policy.

Senator CONROY—It is a fascinating area. It is an important issue and it is a fascinating area. I am just trying to get a sense of Treasury's thoughts.

Dr Parkinson—It is a fascinating area, but I want to make it absolutely clear that, given the way in which comments are so easily misinterpreted or misused, these are not issues the government has made any decision on. The government is in a position where it is contemplating the very first step in this process—that is, should we have a Commonwealth government securities market; if so, what form should it take, how should it be structured and so on. It is a cascading set of questions.

Senator CONROY—They are just logical consequences and having a discussion about the potential.

Dr Parkinson—They are logical corollaries, but they are logical corollaries of something on which we have not yet made a decision on the very first step.

Senator CONROY—But Telstra is up for sale next year, and so you do not have long. The sell down is slotted for the next financial year. I am not saying that it is urgent that you resolve an issue—

Senator Ian Campbell—Mr Chairman, perhaps I could intervene. These questions go specifically to policy advice to the government.

Senator CONROY—No, they do not.

Senator Ian Campbell—They do.

Senator CONROY—I know you have been concentrating on other issues, but I have specifically avoided that.

Senator Ian Campbell—Mr Chairman, it has been made quite clear that these are not only are policy issues but directly relating to the policy formulation process and what that policy advice may look like under a hypothetical situation. They are a long way away from the remit of this committee to look at the estimates for this budget.

CHAIR—Yes.

Senator Ian Campbell—It is a fascinating debate.

Senator CONROY—Just because Senator Campbell says he does not want the questions asked does not mean that I am not allowed to ask them.

Senator Ian Campbell—I am not saying that at all.

CHAIR—Senator Campbell, I think Senator Conroy understands the point.

Senator CONROY—I am doing my best to avoid that very issue.

CHAIR—I am sure he will do his best and, if he does not, I will rule him out of order.

Senator CONROY—Thank you, Senator Brandis. Are you aware of the debt management strategy of Norway, where the government has maintained a bond market whilst still reducing net debt by accumulating and managing assets, including foreign shares and bonds?

Mr Comley—Yes.

Senator CONROY—That is an example.

Mr Comley—I am aware of the Norway strategy. I am also aware—

Senator CONROY—That could be one of the options—

CHAIR—Sorry, Mr Comely, you were about to say?

Mr Comley—I am also aware of the motivation for the Norway strategy. That is more related to the fact that they have substantial revenues from petroleum revenue and a concern to smooth, in a sense, the expenditure over time and so build up some assets while the petroleum revenues are high.

Senator CONROY—Dr Henry, as I have said, has indicated that they are considering those issues, and yet you have indicated that you are having discussions with the markets. Do the discussions that you are having with the markets involve—

Dr Parkinson—We will be having.

Senator CONROY—I think we have had some. They have been raising them for a while.

Dr Parkinson—Yes. People have been raising the issue with us, but we are awaiting a decision on how we will proceed with the consultation process.

Senator CONROY—Those discussions you have had at this stage: are they just about whether we need a bond market, or do they go to what the options are. Do they say, ‘Well, look what’s happened in Norway’? Do they raise these issues with you as solutions?

Mr Allen—The dialogue that we have with financial market people goes across that broad range of issues that you mention. A number of market commentators are very strongly of the view that gross bond outstandings should be maintained at these sorts of levels; in fact, some say they should be increased. Other commentators have an argument that is different and perhaps more along the lines, as referenced by Dr Parkinson earlier, of some of the views of the Federal Reserve in the US, which is that maybe benchmark liquidity status can switch from one market sector to another. I think the market takes some comfort in looking at the statement that is outlined in Budget Paper No. 7 and also that these changes have been happening in a fairly slow and orderly way since the mid-1990s in government security outstandings. In the context of what we outline in Budget Paper No. 7, people are taking comfort from the fact that our focus is to maintain liquidity in our benchmark lines.

Senator CONROY—Do you think AOFM would be appointed to manage the government assets, or would that be private? These are parts of the options. I am asking whether there is a preferred view.

Dr Parkinson—It is way too far off into the future for us even to contemplate the issue, I think.

Senator CONROY—Have you had a chance to chat with the RBA yet?

Dr Parkinson—About this issue?

Senator CONROY—Yes.

Dr Parkinson—We talk to the RBA about many things, and this is one of the things that we would talk to them about.

Senator CONROY—Did they have a view?

Dr Parkinson—They have a view.

Senator CONROY—Are you able to share it with us?

Dr Parkinson—I think that is an issue that you want to raise with the RBA, not with me.

Senator CONROY—Unfortunately they do not come before any committee that I am on, and so I am stuck with just asking you. I am sure it is not a state secret. I am sure they would not mind chatting about it.

Dr Parkinson—I am sure they would not.

Senator CONROY—Are they concerned?

Dr Parkinson—I do not think they would have any particular problems in making clear their view.

Senator CONROY—Are they concerned?

Dr Parkinson—I do not think so. Looking at how they have changed the way in which they intervene in markets, they now engage in repo operations using a much broader range—as I understand it, and I stand to be corrected—of instruments than just Commonwealth government securities on issue. So, in one sense, they have been changing their behaviour patterns anyway.

Mr Comley—In fact, I believe the governor gave evidence to that effect last Friday. I could read the transcript but I think—

Senator CONROY—No, I will track it down.

Mr Comley—There were words along the lines of ‘using Commonwealth government securities is convenient but there are other options’—and they have been moving into other options in recent times to undertake open market operations.

Senator CONROY—What is the next step? Will there be any public consultation before a final decision is made?

Dr Parkinson—That decision has to be made by the government.

Senator CONROY—Senator Campbell, in terms of the issue that we have been talking about, before there is a final government decision will there be any public consultation?

Senator Ian Campbell—Treasury has made it quite clear that there will be consultations with key stakeholders.

Senator CONROY—I appreciate that, and it is clear from the evidence that—

Senator Ian Campbell—And, if you have any recommendations as to other stakeholders that you think we should consult with, I am sure we would be happy to receive them.

Senator CONROY—Just the old public; that is all. I am just wondering whether there will be a public discussion on it, rather than just the stakeholders.

Senator Ian Campbell—This is a public debate we are having now. It is actually available on the Internet across the entire world.

Senator CONROY—Yes, but you are not able to answer any questions about policy.

Senator Ian Campbell—In fact, the Norwegians, if they want to go to www.senate.gov.au, can actually follow the debate live online.

Senator CONROY—I am sure they appreciate that.

Senator Ian Campbell—It is a very good debate to have.

Senator CONROY—But you keep trying to curtail my questions on it. It is a bit hard to have a public debate when you are trying to gag the questions and the Treasury officers are concerned that they might be crossing across into policy advice. But, if you would like to free them from that so that we could actually have a more thorough discussion on it, I would certainly welcome it and so would the Norwegians you have just advised to tune in. Will there be any public consultation?

Senator Ian Campbell—Senator, I have restated the view that has now been stated on at least four occasions this morning: the government will be taking the views of key stakeholders. Perhaps you have recommendations that there are other members of the public, any particular people, members of unions in Victoria or somewhere else, that you think we should consult. This government consults broadly on these policy issues, and there are key stakeholders who obviously have an interest in this area. If you think there are other

stakeholders and that we need to put an ad in the paper saying that anyone who has an interest in Commonwealth bond markets should please send Dr Parkinson a submission, then your suggestion will be considered with the due weight that your suggestions are usually considered.

Senator CONROY—That is what I always enjoy about you: your good temper. Will there be a discussion paper issued before a final decision is made?

Dr Parkinson—I am sorry, I am not trying to be obstructive but—

Senator CONROY—I have not accused you of it.

Dr Parkinson—No, I am getting in ahead. As you have said, maybe I am anticipating where you are going. This really is a matter that is before the Treasurer at the moment: a range of options of government.

Senator CONROY—I was actually asking that last question of Senator Campbell again. Is the government considering issuing a discussion paper?

Senator Ian Campbell—It is an issue that is before the Treasurer at the moment. Without trying to be provocative, it is a very good problem for government to have. It is one that is the culmination of at least six years of very hard work at trying to reduce the debt that was inherited from an Australian Labor Party, which will go down in the annals of Australian economic history as economic wreckers and vandals after having run the debt up to such massive levels. It is a very nice problem for the Treasurer to have to deal with what happens when we have paid off that \$96 billion of debt we inherited from Mr Keating, Mr Hawke and Mr Beazley.

Senator CONROY—You forgot Mr Crean. If I could turn to Budget Paper No. 1, 2002-03, page 12-10, I would like to ask about 'Interest from other sources' shown in that budget paper. Can I confirm that the swap interest received is received by AOFM?

Mr Allen—Again, our numbers are going to make up the dominant share of that line. Obviously, we do not prepare the statement, but it is our understanding that that would be the case.

Senator CONROY—Could you please explain, if you can, the other—it is actually listed as 'Other'—subcomponent, that rises from \$498 million to over \$2 billion over the forward estimates period? DOFA said it was AOFM which received this interest.

Mr Allen—Yes. I was watching your discussion with Mr Smith yesterday afternoon on this very issue.

Senator CONROY—Commiserations!

Mr Allen—I think the answer that he outlined to you was that there are a range of agencies, of which AOFM is obviously a particular player, that make up the particular line. Again, these numbers are numbers that are presented to parliament by Finance. I think that, in the context of that discussion yesterday, we would be happy to liaise with Mr Smith and ensure that the right information is presented in terms of what our component of that number is.

Senator CONROY—That is great. Thanks. Could you tell us on which assets AOFM is earning interest, other than swaps?

Mr Allen—The short answer to that is no. The reason for that, as outlined in note 11, is that we net off the financial asset holdings—effectively the difference between gross and net

debt—from a balance sheet perspective. We do not actually disclose what level of financial asset holdings that would relate to.

Senator CONROY—Why not? Is it a commercial issue?

Mr Allen—There are a range of sensitive issues associated with making that very public statement in terms of exactly what level of financial asset holdings we would—

Senator CONROY—Would that affect your position in the market? Is that why?

Mr Allen—That is one of the very sound reasons.

Mr McCray—Obviously, in coming up with estimates for interest revenue, we have to make some assumptions about levels of assets and indeed levels of gross debt. I would describe those assumptions as technical assumptions, working assumptions, but—

Senator CONROY—These are not guesses; these are budget papers. This is not back-of-the-envelope stuff.

Mr McCray—No, but they are working assumptions. In part, at least, on the table that you are referring to there are interest revenues in respect of AOFM investments built into those numbers.

Senator CONROY—I was asking about other than swaps; swaps are broken out separately.

Mr McCray—Swaps are identified separately; that is right.

Senator CONROY—What were the assets that you are earning on?

Mr McCray—You are looking at the ‘Other’ line.

Senator CONROY—I am just wondering what the other assets were. Does that reveal your position?

Mr McCray—In part there are AOFM investments in that ‘Other’ line. It is not the whole lot, but it is a significant part of it.

Senator CONROY—If other people are listening or if someone reads this later, is there a problem with their knowing what your assets are?

Mr McCray—These projections are based on working assumptions about what a split between gross debt and investments might be. But, as Dr Parkinson has indicated already, because that is a policy matter on which no decisions have been taken—

Senator CONROY—So why is it rising so sharply?

Mr McCray—There is a working assumption that there will be a certain stock of gross debt and a certain stock of investments, but it does not have the status of any kind of government policy or commitment. It is just a working assumption made for the purpose of budgeting.

Senator CONROY—One and a half billion dollars is a pretty big working assumption. I think people are entitled to know what the working assumption is.

Mr McCray—I can only refer back to note 11, which says that we have not come to a policy view on the precise split.

Senator CONROY—I appreciate the government have not come to a policy, but what assumption have you made that has a \$1½ billion movement in this figure?

Mr McCray—We clearly made an assumption that there is a reasonably sizeable pool of investments generating a reasonably sizeable amount of revenues.

Senator CONROY—So that means you have bought assets? The logical consequence of what you have done there is that you must have bought some assets.

Mr McCray—No, these are projections.

Senator CONROY—You must have projected you bought some assets.

Mr McCray—We are assuming that there is a pool of assets but it is a working assumption that has no policy significance.

Dr Parkinson—I think the point that Mr McCray is trying to make is that, for the purposes of the budget papers, it has just been assumed that assets accumulate. Were it to be assumed that the CGS market was run down, that number would be commensurately smaller but the interest expense would be lower. In a sense it is the gap between interest paid and interest received that is important. If you try and tease out too much from either the interest expense line or the interest paid line, we are basically in a sense prejudging what decisions a government may make.

Mr McCray—That is right.

Senator CONROY—I do not want to sound silly but the fact that you have made the assumption is a matter of some worthy discussion. I think I am entitled to ask them why they have made that rather than a different one and I am entitled to ask about the \$1½ billion.

Dr Parkinson—You are entitled to ask a question, yes.

Senator CONROY—Is this the interest on assets on deposit at the RBA?

Mr Allen—That is the current form of our investment strategy, yes.

Senator CONROY—But on a five per cent rate of interest, \$2 billion of interest implies \$40 billion worth of assets. And that is a low level of interest.

Mr McCray—I do not think we can comment on what yield we might be earning on our assets.

Senator CONROY—Is it an indicative figure as to the size of the asset base that you would have built up to be receiving that much interest? That is not an unrealistic assumption.

Mr McCray—As I said, there is a working assumption about the volume of assets that might technically arise and depending on what yield you assume those assets might generate then, yes, you can make certain assumptions about the volume. I guess that is correct.

Senator CONROY—I am not asking you to confirm it. I am just saying that as an indicative figure—and for anyone who ever reads this it is purely Senator Conroy's indicative figure, not the AOFM's—the size of the assets off a five per cent rate of interest on \$2 billion of interest earned is about \$40 billion. That is just maths. That is my working assumption, if I can quarantine you completely from it. So everyone is happy that it is just my working assumption.

Mr McCray—Yes.

Mr Allen—Yes.

Senator CONROY—I will not go any further on that. In the Treasury portfolio budget statement at 'Part C, Agency Budget Statements—AOFM' on page 109, under 'Assets' is a subcomponent 'Investments' of \$6.8 billion in 2001-02.

Mr Allen—\$6.764 billion.

Senator CONROY—This asset disappears in 2002-03. What is this investment and why does it disappear?

Mr Allen—Again, that is consistent with our policy of netting.

Senator CONROY—It is used to pay down debt?

Mr Allen—As we have outlined with respect to note 11, we do not provide any detail in terms of what the actual number will be.

Dr Parkinson—Essentially, you are right. It is there in the past. We can tell you what it was. But going forward, because we do not know whether we will be running a CGS market of \$50 billion or \$100 billion and assets of zero or X, the numbers are netted up. So the \$6.764 billion is for 2001-02.

Senator CONROY—It is all blank in the out years?

Dr Parkinson—That is right, and that is the reason for it. We have to make some working assumption about what might be done, but that has no status. If we could, we would put in a net line, but that is not the way the papers are put together.

Senator CONROY—The working assumption is that you pay down the debt?

Mr McCray—If you move further down that table you will see that the 'Loans—Commonwealth securities' line is exactly consistent with what you just said: we are assuming a netting.

Senator CONROY—On page 109, table 3.8 shows an \$11.4 billion reduction in debt in 2001-02—which is probably the big year we were just referring to. I would like to confirm how this debt would be paid out.

Mr Allen—The debt would be repaid in effectively two ways: one would be to reduce financial asset holdings and the other would be to make funds available through another part of the budget, if there were a budget surplus. Depending upon the source of that revenue, that would be then applied to the repayment of debt.

Senator CONROY—In 2002-03 there is a \$2.1 billion cash surplus forecast and asset sales of less than \$2.9 billion—and that is mainly Sydney airport. Does this \$6.8 billion make up the balance?

Mr Allen—One of the issues that we have outlined is outstandings in the Treasury note market. We have outlined in the budget paper that we will be moving to reduce the level of outstandings in future years. I do not have the specific numbers to run through them with you at the moment, but basically source and application of funds will enable us to reduce the level of gross debt outstandings from \$64 billion to \$52.6 billion. We are happy to take on notice the specific movement numbers if you would like that.

Senator CONROY—Thank you. Also on page 109, swap principal is shown to decrease from \$2.4 billion to \$0.7 billion over the forward estimates period. Could you explain that? As debt is paid down, is swap exposure also reduced?

Mr Allen—Our swap principal outstandings? Yes, that is right.

Senator CONROY—On page 98 of the agency budget statements, the average staffing level is assumed to increase from 30 in 2001-02 to 37 next year.

Mr Allen—That is right.

Senator CONROY—Can you tell me the classification of these seven new staff, what they will be paid and what functions they will perform?

Mr Allen—In terms of the specific details of the projected pay levels, I can provide that detail to you on notice. Effectively, the AOFM operates within a similar classification level, along with all other—

Senator CONROY—No, I am happy for you to just take it on notice. I would like to ask some questions about the AOFM investment strategy for government liabilities resulting from the famous review that was completed in September 2001.

Mr Allen—Do you mean—dare I say it—the foreign exchange?

Senator CONROY—That is what it was. Will those seven people who are coming on board be asset managers? Is that what you are advertising for?

Mr Allen—Sorry?

Senator CONROY—I mean the seven staff. Are you hiring asset managers?

Mr Allen—I am not sure of the basis of that suggestion.

Senator CONROY—So Treasury has given you seven new staff and you do not know what they are going to be doing?

Mr Allen—No, the change from 30 to 37 ASL reflects the fact that when the agency was established, the numbers for staff were projected to be in the area of 40. The number of staff that began with the agency upon the transfer from Treasury was in the low twenties. Progressively, over the last couple of years we have been increasing staff numbers. The increment of staff numbers has been specifically in respect of our current functions, which are to do with debt management.

Senator CONROY—So there are no positions of asset managers amongst the seven?

Mr Allen—We can run through how we split the organisation up into different groups. Within those groups we have particular staff responsible for particular activities. One of the key activities that we are responsible for is liquidity management—the Commonwealth's cash flow—and, in technical terms, we are obviously making deposits with the Reserve Bank. A number of members of our—

Senator CONROY—I will take that as a yes, Mr Allen, to save time.

Mr Allen—I am trying to answer the question, in the sense that we have staff—

Senator CONROY—You must know what you have advertised in the papers, in the ads.

Mr Allen—Most of that recruitment has actually occurred.

Senator CONROY—Then you must know what they are doing.

Mr McCray—The average staffing level in 2001-02 is 30, as the document records. The number is currently 34, so we are looking at three additional positions over the year ahead, which would take us close to the estimate of what we envisaged a fully-fledged AOFM to be operating at. We are not advertising for asset managers to fill any of those three positions.

Senator CONROY—Could I get a copy of the ads, and could I get a list of the functions of the 37 so that I can have a look?

Mr Allen—Certainly, Senator. We are happy to provide that.

Senator CONROY—I would like their responsibilities and individual breakdowns. If you are planning any more ads for the three, could you give me a description of what those three roles are going to be.

Mr McCray—Certainly.

Senator CONROY—We know about the decision to end the policy of swapping liabilities into US dollars; that has now been well and truly debated as part of that September decision. Were there any other changes? I am talking about the investment strategy review that was completed in September 2001. It is when they decided to end the policy of swapping, I believe. What else did it include?

Mr Allen—I do not think there was any other material change to our operations.

Mr McCray—It was a review of foreign currency exposure, so it was quite narrowly on that issue.

Senator CONROY—There were no changes as to how interest rate risk was managed in the portfolio?

Mr Allen—No.

Senator CONROY—Is that being reviewed, given that AOFM is in continual breach of its limits on interest rate risk?

Mr Allen—I will point out two issues to you.

Senator CONROY—You are in breach of your interest rate risk guidelines, aren't you?

Mr Allen—We would not want to see that as being representative of our position. We are not in breach of the interest rate duration target range and we have provided some significant detail in terms of how that exposure is managed. With respect to our review of the liability benchmark we have outlined—and we have been very transparent in terms of making that statement—to financial markets and to parliament that we are in the course of reviewing our interest rate duration benchmark and benchmark framework. We see that as part of our normal course of business and it would be inappropriate if those sorts of reviews were not undertaken on a regular basis over time, as they have been in recent history.

Senator CONROY—Are you above your maximum duration limit?

Mr Allen—On occasion we do have a duration measure.

Senator CONROY—And are you above it?

Mr Allen—At times we are above that target range.

Senator CONROY—How long have you been above it?

Mr Allen—If you look at the table that we present in our annual report, by way of example, you would note that our duration will at times be above the target range; at other times it will be below. We have noted in our review of portfolio management activities that that duration targeting is subject to quite a degree of volatility due to a number of factors, one of the factors being the seasonal nature of the Commonwealth's cash flow. So on one specific day you may find that our duration measure—

Senator CONROY—Should we go to page 32?

Mr Allen—Certainly.

Senator CONROY—That might help us clear this up. That has the details of the interest rate duration.

Mr Allen—That is right. I take your question to be about the duration that we recorded at the end of that financial year, which was slightly in excess of 3.5?

Senator CONROY—And the year before?

Mr Allen—At times it was below it; at other times it was slightly above the 3.5.

Senator CONROY—So in terms of your evidence earlier about not being in breach, and then only occasionally being in breach, if your average figure is above then you have to be above, a lot.

Mr Allen—As we have outlined in some of our descriptions, particularly on page 36, the durational target is an operational target and there are going to be times, given the size of our portfolio and given the size of the swings, when it will not be possible to maintain it.

Senator CONROY—Does the Reserve Bank ever breach these sorts of targets?

Dr Parkinson—Senator, I think that is a question you might want to address to the Reserve Bank, not to us.

Senator CONROY—I am sure their answer is, no.

Mr Allen—As we have pointed out on page 36, we are applying some judgment to achieving our duration target. That judgment is brought about by the nature of the debt management challenges we have. I will point out a couple. Obviously the size of the Commonwealth's portfolio is significant; it dominates domestic financial markets. We have substantial seasonal cash flow that has an impact on portfolios. A myopic view of what the duration is on a particular day would lead to very significant levels of debt management transactions in order to ensure that the duration stays within that very narrow—

Senator CONROY—That is what you are paid to do, though—manage the debt.

Mr Allen—No, I would argue that our objective is to ensure that the portfolio duration will stay within the targeted range.

Senator CONROY—So page 52 of the Auditor-General's report, which shows that you have been in breach right back to 1997, is wrong?

Mr Allen—There have been times over that period when we have been in breach of the very narrow duration target.

Senator CONROY—I accept that you said that when I asked whether the AOFM was in continual breach of its limits on interest rates, though it is possible to characterise it as such given the Auditor-General's report. However the Auditor-General's report shows that, right back as far as 1997, you were regularly in breach of these limits.

Mr Allen—We interpret that target range as being the operational target, taking into consideration the size of the Commonwealth's portfolio. There is a required set of transactions to bring you within that very narrowly defined target range and there are public policy considerations associated with that issue. We are also required to apply a degree of judgment when making these decisions, because obviously these charts do not show any information with respect to the forecast period. The volatility in the duration of the portfolio is measured

on a day-to-day basis. We are required to manage this task, and it is evident in historical data on duration that the swings are quite extreme and can occur from one day to the next, depending upon the underlying change in the cash flow.

Senator CONROY—Do you think you should revise upwards your duration limits? It is one way to get inside them.

Mr Allen—As we have indicated in our annual report, we are undertaking a review of these issues. Perhaps that would be one answer, but it would be very dangerous to draw the conclusion that one way to do this would be to lengthen duration or widen the operational band that we work within. There are a number of answers to the problem.

Senator CONROY—I look forward to your review being completed.

Mr McCray—Let me add a few comments there, which go to the issue of managing within this benchmark range. This range exists as a commercial discipline on our operations, but sovereign debt management is not purely a commercial exercise. You have referred to a number of instances where there have been breaches.

Senator CONROY—The Auditor-General referred to many of them.

Mr McCray—In practice, we could have readily maintained our portfolio within those ranges by going out to the financial markets and doing a vastly greater number of interest rate swap transactions than we did, which would have incurred significant transactional costs and had swap transactions going in both directions—say, a big swap on one day, which was unwound the next day. Because of the size of our portfolio, this would have had a very major impact on the operation of domestic swap markets, swap pricing and domestic swap spreads.

As a sovereign debt manager, we have to consistently balance judgments of commercial imperatives versus the public policy dimension and the fact that the scale of our operations has the potential to disturb markets. We have to trade those considerations off, and we are quite comfortable with the trade-offs that have been made from time to time. Technically we have moved outside the benchmark range, but we have done so for good public policy reasons.

More recently—in the last couple of years—there have been some additional factors. Mr Allen referred to the volatility within year cash flows. This is a particular problem of management that arises directly from the reduction in net debt. The Commonwealth has day-to-day within year swings and in the pattern of its revenues and expenses of broadly the same scale they have been for many years. Perhaps it is a little more volatile, but the underlying debt position is shrinking all the time. The amplitude of these day-to-day swings is growing all the time, and this is also having an influence on our capacity to manage within the benchmark range. That is one of the primary reasons why, as Mr Allen indicated, we are reviewing the target.

CHAIR—Senator Conroy, I am conscious that Dr Parkinson and his officers have a commitment at 10.30 a.m.

Senator CONROY—I suspect we will run a little over time.

CHAIR—I wonder if we take morning tea a little early to let them meet their commitment, and we can jump ahead to outcome 3.

Senator CONROY—I think Senator Sherry has some questions. I am happy to break now and hand over to Senator Sherry. Perhaps we could defer until a little later.

CHAIR—Thank you. When we resume, we will proceed directly to Treasury outcome 3.

Proceedings suspended from 10.25 a.m. to 10.42 a.m.

CHAIR—We will resume examination of the Department of the Treasury outcome 2.

Senator SHERRY—I want to get some indication of the process that was followed in the development of the Intergenerational Report. When did the modelling of the projections that are contained in the report commence?

Mr Gallagher—After the report of the commission of audit in 1996, we maintained the capacity that we had for demographic labour force, pensions and aggregate health projections. We participated in an OECD review committee exercise on population ageing in Australia at the end of 1998. The significant development of the capacity beyond then began in 1999. In 2000 there were four very detailed intensive workshops with a wide range of Commonwealth agencies, including the Department of Health and Aged Care, the Australian Institute of Health and Welfare, AVS, Family and Community Services, Employment, Education, et cetera. So we had a wide ranging consultation process in 2000.

Senator SHERRY—When was that in 2000?

Mr Gallagher—It was in April and May of 2000. Towards the end of 2000, we had a consultation process on the approach to economic projections. One of the consequences of that consultation process was the publication—I think, in Treasury's December 2000 *Economic Roundup*—of an article on population ageing and the economy.

Senator SHERRY—Did that include matters relating to health?

Mr Gallagher—No, that particular article was about the potential effects of demographic change and on changes in the labour force and, therefore, potentially changes in the growth of GDP. It concerned those issues and the supply-side approach taken in the report to the projection of GDP.

Senator SHERRY—Up to that stage you were putting in place a skeleton framework?

Mr Gallagher—We were putting in place a framework of projections, consultations and peer review of the technical work in preparation for doing the Intergenerational Report when it was called for.

Senator SHERRY—At the end of 2000, did it include modelling of particular factors in the health area, for example?

Mr Gallagher—Yes, at that time we had developed a component model of health, so we were examining projections of individual health programs. We were also projecting the disability support pension and single parenting payment. So we had added to the range of demographically sensitive programs considerably compared to what we had looked at in 1996.

Senator SHERRY—We did touch on this last night, but it seems to me you are indicating that you had gathered data through these consultations—and obviously other timings in the process—from the health department and then you had put together the projections?

Mr Gallagher—Yes, the projections were done inside Treasury. A lot of the health data came from the Australian Institute of Health and Welfare as well as from the Department of Health and Aged Care, as it then would have been. So we had very detailed information. They also publish very detailed information on their web site.

Senator SHERRY—You had obviously developed your model then? Did you have a working model to put the inputs into?

Mr Gallagher—We had a working model and, obviously, we were testing people out on the methodology and the nature of the results at that stage.

Senator SHERRY—This is the end of 2000?

Mr Gallagher—This is the end of 2000. In 2001 we had further work for the OECD exercise on the public finance consequences of population ageing. At the end of 2001, the actual production of the report was called for.

Senator SHERRY—At the end of 2001, had you done any specific modelling and projections—let us take the health area?

Mr Gallagher—We had the results from the start of 2001, when we had revised our results for the OECD exercise. They had not been further added to, so there was not a great deal of addition to the modelling in this area between April 2001 and the end of 2001. Then we entered into another process where we went through a consultation process again once the report had been called for.

Senator SHERRY—You had modelling at the end of 2001 in the health area, for example?

Mr Gallagher—Yes. In actual fact, we had modelling in the health area in April 2000, and officials were aware of that modelling at that stage.

Senator SHERRY—Let us take it to the end of the year 2001: you had a set of modelling and results at that point in time?

Mr Gallagher—At the end of 2001, there was a set of interim results which had not been updated for some time.

Senator SHERRY—Looking specifically at health, I assume the interim results were passed on to the relevant departments for comment?

Mr Gallagher—Yes, we passed results to them in the consultation processes in April and May of 2000 and again in 2001.

Senator SHERRY—Let us take the Pharmaceutical Benefits Scheme and the disability scheme specifically: were there any factors that changed from the end of 2001 up until the final figures were produced for the report?

Mr Gallagher—A range of factors have changed over the period that we have been working on it. If we take the disability support pension, as new data comes in and after a period of long economic growth, the coverage rates of the disability support pension have started to drop off. For the disability support pension, the effect of the data was to lower the projections compared to what they had been stated previously. For the Pharmaceutical Benefits Scheme the effect was the reverse. In the 2000-01 financial year, that scheme grew by 20 per cent nominally. So there was a very high growth rate coming out of the Pharmaceutical Benefits Scheme, which was higher than the gross that we had been projecting in 2000.

The other thing that changed between the end of 2001 and the report—and this was particularly instrumental in the report, as we discussed last night—was that the government in their budget process decided to take measures. The effects of their measures are reflected in the projections in the report, which made a significant change to both of those projections.

Senator SHERRY—What was the projection for the Pharmaceutical Benefits Scheme at the end of the year 2001?

Mr Gallagher—I cannot remember exactly what the projection was. There has been a variety of numbers as they have gone ahead. As I said, it depends very much on the availability of information—particularly information on that program from the Australian Institute of Health and Welfare as it requires the isolation of the pharmaceutical benefits subsidy from other PBS expenditure because that is the demographically sensitive component.

Senator SHERRY—At that time you had a set of figures. You have explained that there were two factors that necessitated an update. I am pressing this issue. Can you recall what the projection was at that time for the Pharmaceutical Benefits Scheme in 2002, before it was subsequently revised?

Mr G. Smith—It was a work in progress at that time. I do not think we published it at that time.

Senator SHERRY—No, I know it has not been published because I could not find the figure. You cannot recall it off the top of your head?

Mr Gallagher—No, I cannot.

Mr G. Smith—We would need to take on notice any requests for the publication of material that has not yet been published or may not be published because it was work in progress.

Senator SHERRY—I appreciate the fact that Mr Gallagher has indicated that there was a set of revised figures at the end of 2001 and that the new factors had to be taken into account. You mentioned that the disability support pension resulted in a variation downward?

Mr Gallagher—Yes. As the new numbers came in and particularly from the projections we had in 2000—the most recent data we had when we started was 1998 data—they meant that the growth in the coverage rates turned and flattened. That is reflected in the current projections.

Senator SHERRY—Were these changes to the projections discussed with the department?

Mr Gallagher—We have had two intensive periods of consultation: in 2000 and in 2001 leading up to the budget paper and the production of the report. There were not many consultations with departments in 2001 specifically on these projections.

Senator SHERRY—Yes, but at the end of 2001 you had a set of figures. You have mentioned with PBS that there was a revision upwards in 2002. You have mentioned the factors for that final set of figures. Did you consult with the health department?

Mr Gallagher—The numbers for the end of 2001 were dealt with in consultations in January 2002 with the health department.

Senator SHERRY—Were they made aware of the published figures that were to go into the report?

Mr Gallagher—Yes. We have consulted along the way.

Senator SHERRY—So they had an opportunity to discuss the proposed figures that would go into the final report?

Mr Gallagher—Yes.

Senator SHERRY—Who was the liaison person or group in the health department in these discussions?

Mr Gallagher—The liaison officers were Dr Marion Amies and James Jordan. I am not quite sure of the exact title of their organisational unit—it is policy development, policy strategies, portfolio strategies or something. Previously in 2000 we had consulted with a range of other officers, including the statistical experts.

Senator SHERRY—You have indicated that in respect of the PBS cost of \$2,042 there was a substantial revision upwards.

Mr Gallagher—It was revised up and then because of the budget measures it was revised down, so it has gone both ways.

Senator SHERRY—At that point in time, had you used the 1.75 figure on productivity?

Mr Gallagher—Yes, the 1.75 on productivity has been around for a while. It was the number which the OECD chose for its international comparisons studies, so certainly from the start of 2001—and I imagine even in 2000—1.75 was one of the variations.

Senator SHERRY—That raises an interesting point. You picked 1.75 because of the OECD?

Mr Gallagher—There is a variety of reasons. There is the 30-year trend in Australia, which suggested a number of that magnitude. As always in these things, we keep an eye on the international literature. The fact that it was found to be an internationally accepted assumption meant that there was an additional reason to use it.

Senator SHERRY—Why does the OECD use the figure of 1.75?

Mr Gallagher—They consider it to be—

Senator SHERRY—An average?

Mr Gallagher—I think it is an average of what appear to be reasonable productivity rates of the member countries.

Senator SHERRY—But isn't it true that Australia's productivity performance has been in excess of the OECD average? Why do we get benchmarked down to the OECD average?

Mr G. Smith—The 30-year average for Australia is 1.75.

Senator SHERRY—I understand that, and I understand that is one of the issues.

Mr G. Smith—So your comment actually relates only to the more recent decade?

Senator SHERRY—Yes; in the last decade we have certainly had above average, stronger economic growth and productivity growth.

Mr Gallagher—We have included that in the sensitivity analysis. To do a long-term projection we have taken long-term history. Then we have said, 'We'll look at the nineties,' and we have put the nineties projection through the sensitivity analysis.

Mr G. Smith—It does not make much difference, as it turns out.

Mr Gallagher—It does not make a lot of difference. As I explained last night, for a number of the spending programs the unit costs are effectively indexed to wages. If unemployment is stable, there is good reason to believe that wages would increase in line with labour productivity.

Senator SHERRY—I find it interesting that in the document—and I think correctly so—there is a tribute to Australia's economic performance over the last decade. Obviously, in comparison to the OECD, it is a superior performance, on average. But we are not using that superior performance in terms of factoring in productivity in the future.

Mr G. Smith—We have answered that several times: we have used the long run history to do a long run projection.

Senator SHERRY—But if we took into account Australia's superior economic performance, about which we hear a lot, we would factor in a different factor in respect of productivity.

Mr G. Smith—We have answered that several times as well: yes, we have provided that alternative in the sensitivity analysis and it does not make much difference. They are benchmark data. You make your call. You say it is conservative but, as it turns out, it does not matter that it is slightly conservative because it makes very little difference.

Senator SHERRY—We would like to see what the alternative is with the two per cent productivity. I put that on notice.

Mr Gallagher—You asked for that last night.

Senator SHERRY—Yes. Going back to the discussion we had about the modelling up to the end of 2001, you indicated that changes were made, particularly to the Pharmaceutical Benefits Scheme. When were those numbers for the report finalised? Was it early 2002?

Mr Gallagher—No, the numbers could not be finalised until the budget decision was known and the budget costings were known and we could factor those in. So in actual fact the numbers were not finalised until around the end of April.

Senator SHERRY—So what you had at the beginning of 2002 were the projected costs without factoring in the measures that were announced in the budget on budget night.

Mr Gallagher—Obviously those decisions had not been taken as yet. We went through a process of rechecking all projections against the forward estimates.

Senator SHERRY—Obviously those measures announced in the budget in respect of pharmaceutical benefits and the disability support pension would have lowered the result. Is that correct?

Mr Gallagher—Yes.

Senator SHERRY—But that obviously occurred after January.

Mr Gallagher—Yes, the lowering occurred after January.

Senator SHERRY—When the proposed budget measures were factored in and new results obtained—because the projections are based on including those budget measures—were they provided to the department for further consultation?

Mr Gallagher—I think as the numbers have changed they have been made available to departments.

Senator SHERRY—Were they made available before budget night?

Mr Gallagher—Yes.

Senator SHERRY—Were they given the opportunity to provide feedback?

Mr Gallagher—Yes.

Senator SHERRY—So I can be clear on this, at the beginning of 2002 you had factored in the program measures that had been announced in the previous year in the projections?

Mr Gallagher—We would have factored in the measures from the May 2001 budget and we would have used the portfolio budget statement in benchmarking our projections.

Senator SHERRY—The main issue in that budget measure last year was the expansion of the coverage of the PBS to Australian seniors, wasn't it?

Mr Gallagher—There were issues. Obviously there is significant demand for pharmaceuticals and there was major growth so it is one of the things that influenced the forward estimates. But in fact there is substantial underlying growth influencing the forward estimates.

Senator SHERRY—I do not want to go into individual health comparisons, but in your modelling do you take into account the impact of a short-term cost which may save money in the longer term in other areas of health?

Mr Gallagher—The modelling is not sufficiently sophisticated to cope with negative feedback groups. This is coped with indirectly. The actual observed growth rate that we see and use—the real per capita age adjusted growth rates—have been influenced over the years by a succession of savings measures and preventative strategies. Inasmuch as they are reflected in the historical growth rates—and as Mr Smith has explained we are looking at what happens if the trends of the past were to continue—they are indirectly coped for. Specific feedback mechanisms are not modelled in health. They are modelled, I think, only for the aged pension, because we have the sophisticated RIMGROUP model which looks at the build-up of superannuation assets and the impact that has on the aged pension. That is the area where we have very elaborate modelling of negative feedback.

Senator SHERRY—There has been a lot of public debate about new medical technology, and focus on the costs. Can you factor in, for example, developments in genetic technology that may eliminate or reduce the need for it?

Mr Gallagher—As Mr Smith explained last night, if there is a paradigm shift, we have not caught it. There could be a variety of paradigm shifts. There have been substantial major productivity improvements in health. Diagnostic imaging, pathology testing and day surgery are major productivity improvements in health. The consequence of those major productivity improvements has been that the unit costs of those services have dropped. The consequence of the unit costs dropping is that far more have been demanded and utilised. In fact, the volume effect has cancelled out the unit cost effect.

Senator SHERRY—Some of those issues you just raised about the dynamic changes would not have been known about 20 years ago, because they did not exist. They might have been in development stage, but we would not have known about them, would we?

Mr Gallagher—Possibly not. I suspect day surgery was being talked about 20 years ago, but obviously revolutions have occurred. We have not seen real health costs per capita decline as a consequence. Our current policy in health is always to reassess new medical technologies and to make them available, so the current policy in health includes technological change.

Mr G. Smith—The thing about paradigm shifts, of course, is that they can operate either way. I know there is talk and lots of optimism—and I hope it is all true—that there is going to be some of these developments which could shift things in a favourable direction, but there is also talk about the ecology of viruses and bacteria being extremely adverse as a result of the

work of health services over the last century. When you go to paradigm shifts, we have to observe that they could cut either way.

Senator SHERRY—If we take the paradigm shift of genetic technology—not that it will benefit any one of us—and look at the projections for life expectancy based on some of the discussion at the moment, we will be looking at average life expectancies of 120, which would be a real paradigm shift. Sadly, it is not going to benefit us—our kids maybe and our grandchildren, but not us.

Mr G. Smith—Hopefully another HIV virus or something does not emerge. What you say could happen but, let us be clear, there are risks as well.

Senator SHERRY—There are risks, but the average life expectancy has been gradually increasing.

Mr G. Smith—In the developed world.

Senator SHERRY—In the developed world, that is right.

Mr Gallagher—That sort of change is well beyond both the 25-year and 100-year improvements in life expectancies. We have our own very detailed models of life expectancies and have been looking very carefully at the trends. In doing the sensitivity analysis, the balance between the 25-year trend and the 100-year trend was considered in terms of doing the lower mortality projection. I think it would be very difficult—and this is in the book—for us to see life expectancy at birth reaching 120 on the basis of the trends we have observed over the last 25 and 100 years.

Senator SHERRY—As you say, it is very hard to include these paradigm shifts.

Mr Gallagher—One of the major issues in health is the issue of compression of morbidity: as life expectancy is increased, there is an issue of whether the proportion of your life which is spent without disability has increased proportionately. Basically, in Australia, the jury is still out on the issue of compression of morbidity into the later years of life. If anything, the labour force trends and the mortality trend have gone in exactly the opposite direction: we are living longer, if you look back over the last 25 years, but working lives have shortened. Labour force participation, particularly during the 1980s—and the charts are at the back of the book—have decreased. So there is always this issue about the relationship between life expectancy—whether that carries through to morbidity—and how it relates to labour force participation.

Senator SHERRY—There are a range of factors that drive labour force participation.

Mr Gallagher—Indeed.

Senator SHERRY—When we look at the average retirement age at the moment and the reasons why people retire, often it is forced retirement because of changes in the labour market.

Mr Gallagher—And there is a range of factors. The National Strategy for an Ageing Australia has written extensively on that issue. There is also a report by a House of Representatives committee on the employment of mature age workers.

Senator SHERRY—I am glad you raised that because that was the next area I was going to go to. The National Strategy for an Ageing Australia spent, I think, some five years in the preparation profiling. Was that referenced in the report?

Mr Gallagher—I am not sure if we have specifically used the national strategy as a reference in the report. RIM itself was heavily involved in the preparation of most of the national strategy discussion papers and I personally have been on the committee that has guided the national strategy reports. The Assistant Treasurer was a member of the ministerial committee which oversaw the work of the national strategy.

Senator SHERRY—Is that the current Assistant Treasurer or the previous Assistant Treasurer?

Mr Gallagher—Senator Kemp.

Senator SHERRY—Prior to the last election, which minister was responsible for overseeing the development of the National Strategy for an Ageing Australia?

Mr Gallagher—Then Minister Bishop.

Senator SHERRY—That is what I thought. When the final projections were generated for this document, it would have been the current minister in that area—who is that?

Mr Gallagher—Kevin Andrews, I think.

Senator SHERRY—Did they have input and were they consulted with?

Mr Gallagher—Yes. They were the Office for Older Australians; they may have had a name change since the election. But certainly that office was extensively consulted, has been involved in the meetings on this report and has had some impact. One of the things that this report does, for example, is use the evidence for increasing labour force participation, which was something that they were particularly interested in—that is, the sensitivity analysis. The increasing educational participation at older life was also something that that office was particularly interested in and is another issue in this report.

Senator SHERRY—I notice in his budget speech the Treasurer stated that policy responses to a slower rate of growth domestic product as projected in the IG required a focus on the three P's: population, participation and productivity. What is there in the 2002-03 budget papers that addresses these three P's?

Mr G. Smith—I am not sure that I have got that degree of familiarity required. I know that the government has been thinking quite a lot about population issues and I know that there have been initiatives taken to provide assistance to families and so on, which were part of their election program, of course—the baby bonus and that sort of thing. So I suppose there are those broader contexts which are provided for in the budget, but I would not be able to go to specific references.

Mr Gallagher—I think there are a couple of factors that you could mention. The minister for immigration has announced increased migration targets. I think that was done on 10 May, just before the budget. In terms of participation, there is significant emphasis in the budget on the participation of people who are on or who might apply for disability support pensions. There is continuing emphasis on the welfare reform process in terms of that being about increased participation. Productivity is an issue which the government addresses in a number of ways.

Mr G. Smith—Including labour market reforms and reforms in those areas. Really you have a whole sweep there, which is pretty well a broad sweep of policy. But I think the Treasurer's remarks were not so much talking about what has been done, although there have been all those things that we have just mentioned, they were also really focusing on what sorts

of things Australia needs to think about, or continue to think about, going forward. I think he was thinking forward to some extent in that.

Senator SHERRY—Do increased migration levels improve productivity?

Mr Gallagher—There is a debate about that. I think the department would take the view that, because it is a skilled migration program and a lot of the people recruited are more highly educated, those people would be more productive in the labour force. In our own projections, we have merely assumed that they have the productivity and labour force participation of a person of their age. We have not differentiated on the basis of education and skills.

Senator SHERRY—So you have assumed no impact on productivity one way or the other?

Mr Gallagher—Not so much on labour productivity, because that has been more or less assumed to be constant for the projection period, but there is certainly an effect on participation that is in these projections, because the migrant intake is younger than the existing population. So there is an effect there in terms of total product.

Senator SHERRY—A younger migration intake has an impact on the ageing population too, doesn't it?

Mr Gallagher—Yes, it can have an impact, depending on how you want to measure the ageing of the population—say, if you take the age dependency ratio. We may have presented that in the report.

Mr G. Smith—We have a sensitivity on migration as well.

Mr Gallagher—Chart 32 on page 64 of the Intergenerational Report shows the impact of a 50 per cent increase in migration, with all the assumptions stated. There are three lines, showing the effect on real GDP, the change in the ratio of those aged 65 and over to those aged 15 to 64, and the effect on real GDP per capita.

Senator SHERRY—On the fertility rate, are there any programs that have been implemented—I do not know about here, but overseas—which have clearly impacted on the fertility rate?

Mr Gallagher—One has come to my attention. The French have a program which was paying what was called a 'parent education allowance' but was essentially a form of maternity leave which was at half the guaranteed minimum wage. The French originally were paying that for a third child and then they took it down to a second child, and there has been an improvement in the number of second and third children born. That is one program. I think the program was of the order of 18 billion francs.

Senator SHERRY—What is that in Australian dollars?

Mr Gallagher—It is a bit hard to get it, because the conversion rates you can get out of the paper are in euros nowadays.

Senator SHERRY—When was that program introduced in France?

Mr Gallagher—1994.

Mr G. Smith—Your question is about the impact on fertility. Most programs over the last 30 years have actually aimed to reduce fertility, of course, whether it is the Chinese one child policy or birth control programs through all sorts of environments in the world. Your question is: what about increasing fertility?

Senator SHERRY—Yes.

Mr G. Smith—It is not a very well researched area, but there is some research beginning to emerge on the impact of fiscal incentives and arrangements on fertility. It is an emerging area. I have seen some US research which suggests that there are responses, but I think we would have to say that it is pretty early. This is not an area that is widely researched.

Senator SHERRY—I will have a look at that French program.

Mr Gallagher—Lots of other programs have related to payments to families with children. It would be an open issue whether they have had any effect.

Senator SHERRY—Both here and overseas there are declining fertility rates. In some countries it is forced—China and Singapore have experimented with that. I think you are right: I do not see a lot of material other than the one you have mentioned.

Mr Gallagher—Singapore is trying to be selective. They are trying to encourage more highly educated women to have more children.

Senator SHERRY—I do not think we will be suggesting that in the Australian context. What you can get away with in Singapore is a bit different from here. Is it correct that until 2016-17 the demographic changes will have a positive impact on the Commonwealth budget?

Mr Gallagher—I do not know that it is all the way out to 2016. Certainly in terms of the way the fiscal pressure is projected in this report that is a changeover point. We are at a point with a high labour force and reasonably strong labour force growth at the moment. There will be issues concerning the labour force participation of the baby boomers as they pass through their fifties and sixties, which before then could impact. The leading edge of the baby boomers turned 55 last year and this year, and turn 65 in 2011-12. That turnaround will occur during that period, but certainly in terms of demographic pressure we see this as being a reasonably good period compared to what will happen as the baby boomers retire en masse and get older.

Mr G. Smith—The actual turnaround from positive to negative in trends is actually more like 2008.

Senator SHERRY—Yes, looking at that chart you are right: it does peak at 2008-09.

Mr G. Smith—I think it is actually 2007-08, and then it starts to go bad from there.

Senator SHERRY—Then it goes the other way in, it looks like, 2016. So you are right: it is quite a good period, peaking in 2007 by the look of it.

Mr Gallagher—In the projections, one of the underlying assumptions relating to that is the assumption about decrease in unemployment. As the population ages there should be increased demand for younger labour such that there would be a decrease in the unemployment rate because of population ageing.

Senator SHERRY—That is a good point. What about at the other end of the scale? At the moment we have people retiring at 58 for whatever reason and people who are older than 58 with increasing participation.

Mr Gallagher—For females there has obviously been increased participation, but a lot of that participation is part time. There is no doubt that there has been some substitution: increased female participation and decreased participation by older males over the last 25 years. There have also been changes in the nature of the economy, which has been related to that participation change. In the report, we are running projections which have a flattening out

of male participation in the 55 to 59 and 60 to 64 age groups and a rising participation for males aged 65 to 69. Overall, the report has rising labour force participation for persons aged 15 to 64. That is made clear in the economics section on page 27, where you get both the participation rate for persons aged 15 or over and a graph of the line of the participation rate for all persons aged 15 to 64.

Senator SHERRY—Interestingly, I noticed in ‘Chart 17: unemployment rate’ that you have unemployment flatlining—is it at about 2004-05 at five per cent?

Mr Gallagher—I suspect that we would take it down to about five per cent at about 2006-07, which is said at the bottom of page 28.

Senator SHERRY—What are the implications if the unemployment rate drops below five per cent?

Mr Gallagher—I think the unemployment rate continuing to fall is one of scenarios. In the lower unemployment rate scenario, the major thing that would be affected in the projection would be the spending on unemployment payments, which was calculated as a drop of 0.07 per cent of GDP. That scenario is a four per cent unemployment rate.

Senator SHERRY—Did you do any modelling on a two per cent unemployment rate?

Mr Gallagher—Not for this report. It is conceivable, but it is something that is well away from what we have observed since the current labour force survey was introduced in 1978-79.

Senator SHERRY—We have had less than a 30-year period where unemployment on average has been much higher than that. Conversely, we had a 30-year period prior to 1970 when unemployment was a lot lower than an average of four per cent.

Mr Gallagher—Female participation was a lot lower than it is.

Mr G. Smith—There was a very different structure of society in those years.

Senator SHERRY—Yes. I hope that you are not suggesting that female participation has increased unemployment?

Mr Gallagher—Female participation has increased the total participation in the labour force.

Senator SHERRY—It has not increased unemployment, has it?

Mr G. Smith—That is certainly not the view we hold.

Senator SHERRY—Is there any research that shows that to be the case?

Mr G. Smith—We are not familiar with that.

Senator SHERRY—Mr Gallagher may be.

Mr Gallagher—I have not looked at that particular issue. We are talking about total levels of participation.

Senator SHERRY—Can you model projections based on a lower long-term unemployment rate of two per cent?

Mr Gallagher—Yes.

Senator SHERRY—Could you take that on notice and do that for us, please?

Mr Gallagher—Yes. It is a very long list.

Senator SHERRY—I know it is a long list, but this is a major area. The Treasurer has urged us to participate in a debate. The information should be out there. You appear to be one of the few groups that has the modelling to be able to do this. In the interests of attempting to share the workload, is there anyone else who can do this modelling?

Senator Ian Campbell—You are not suggesting we contract it out, are you?

Mr Gallagher—Obviously there are a number of people who offer demographic modelling. The shortfall in terms of modelling by other areas appears to have been in the area of labour force projection models. If you look at the work of Access Economics and of Melbourne academics Ross Guest and Ian McDonald, for example, you will see that they do not appear to have well-tuned, fully articulated labour force projection models. In both cases—probably because they are doing macromodelling—they come down to a projection of aggregate participation rates. Guest and McDonald tend to have no changes, and I think Access Economics have an aggregate projection which is lower than the projections in this report. The age and gender specific modelling that we undertake is perhaps more detailed than that undertaken elsewhere.

Senator SHERRY—It appears that, fortunately or unfortunately, your unit is pretty much it in terms of comprehensiveness.

Mr Gallagher—In deciding to go with the production of the report, Treasury took into account that we had a well developed capacity.

Mr G. Smith—If the Senate would like to contract out, you would probably find that people would come forward offering their services.

Senator SHERRY—I am not sure the Senate would be willing to fund contracting out. I think they would see it as the responsibility of the department to meet reasonable requests of the parliament—in this case, the Senate.

Mr G. Smith—I think the Senate has contracted out this research on a number of occasions.

Senator SHERRY—Certainly with respect to the GST there was some specific work done.

Mr G. Smith—I certainly recall that.

Senator SHERRY—But not with respect to the sort of comprehensive analysis that Mr Gallagher and the unit can provide.

Mr Gallagher—In terms of that, NATSEM's dynamic projection model is developing, and I am not fully up to date on where it is at. Certainly what they are attempting to do with DYNAMOD would give them a reasonably powerful projection framework.

Mr G. Smith—My point is that I do not think that we, as the Treasury, want to declare that we are the only people who can do this sort of research. That is not our view.

Senator SHERRY—In the context of budget estimates and the issues we are considering—and the Intergenerational Report is part of the budget documents—it is a reasonable approach.

Mr G. Smith—That was not my point. My point was that, because you were talking about other people, I think Australia has quite a body of good quality researchers.

Senator SHERRY—I do not want to reopen any lengthy debate on this. The economics estimates committee *Hansard* of 4 June at page 180 reads:

Senator SHERRY— ... In relation to the timing of the phase down over the same three years as the proposed phase down of the surcharge tax, have you since carried out new figures based on that phase down?

Mr Gallagher—I have given preliminary estimates based on the phase down, yes.

Senator SHERRY—And you have passed them on to the Treasurer's office?

Mr Gallagher—I have passed them to the Treasurer's office

Senator SHERRY—When did you pass them on, approximately?

Mr Gallagher—It was sometime in the next week.

Senator SHERRY—So, it was last week sometime or the week before.

Mr Gallagher—Yes.

On that basis could I ask that the figures that were given to the Treasurer's office be given to the committee?

Mr G. Smith—We will take that question on notice, as I think we already have.

Senator SHERRY—In reading the *Hansard* of the conversation—

Mr Gallagher—You said this is in relation to the surcharge phase down?

Senator SHERRY—Yes.

Mr Gallagher—The surcharge phase down is in the budget papers.

ACTING CHAIR (Senator Watson)—They have just been given the Treasurer. He might want to comment before they are released.

Senator SHERRY—You said you had given preliminary estimates based on the phase down that you had passed on to the Treasurer's office. I think it was a recognition of the broader issues of the proposed contributions tax changes.

Mr Gallagher—I am not exactly certain of the context of the remarks. I have been in here for 2½ days now and have not had the benefit of being able to read *Hansard*, or much else.

Mr G. Smith—I think we took a question on notice.

Senator SHERRY—Yes, you did, and I actually gave a letter to the secretary of the committee yesterday afternoon. I do not know whether it has been passed on yet. I have concluded on the Intergenerational Report. I do not know whether Senator Allison has some questions in that area.

ACTING CHAIR—Are there any further questions on the Intergenerational Report? There are no further questions.

Senator SHERRY—I have some questions on outcome 1. I do not think we will need Mr Gallagher for this. It relates to the Financial Services Reform Bill, disclosure of fees and charges.

Mr G. Smith—That is actually outcome 3.

Senator SHERRY—Yes, that is later.

Mr G. Smith—If we have finished with program 2, we will leave. I know we have program 3 people available, so you could start that perhaps and bring the AFM in whenever you wish.

ACTING CHAIR—The committee will break for five minutes to sort out the availability of witnesses.

Proceedings suspended from 11.42 a.m. to 11.52 a.m.

ACTING CHAIR—The committee is looking at outcome 3.

Senator CONROY—Can you confirm that Australia is a member of the OECD Financial Action Task Force on money laundering?

Mr French—I believe that is correct.

Senator CONROY—Who attends on behalf of Australia and what is the extent of their involvement?

Mr Grech—The FATF, which Australia is a member of, is primarily coordinated by the Attorney-General's portfolio. It has a number of agencies which are represented. Treasury attends meetings—not on a regular basis, but we do attend. Primarily the coordination legwork for Australia is done by the law enforcement agencies.

Senator CONROY—Who attends on Treasury's behalf?

Mr Grech—I have attended one meeting. The Financial Institutions Division has provided representation at various times but, to be perfectly frank, we have had resource limitations at times and have had to allocate staff to other priorities—insurance matters being one obvious example.

Mr French—Can I clarify: are you asking whether Treasury attends the meetings of the Financial Action Task Force itself?

Senator CONROY—I was probably asking who attends the actual meetings as well as any debrief and briefing meetings and preparation.

Mr French—It would not be usual that Treasury would attend the meetings of the Financial Action Task Force itself, but we are involved in an interdepartmental committee which discusses these issues.

Senator CONROY—You are part of the support group.

Mr Grech—Yes.

Senator CONROY—Mr Grech will be familiar with the nature of the work.

Mr Grech—Yes.

Senator CONROY—Could you explain to the committee the nature of the task force's work and who else comprises the task force? I am happy for you to take some of that on notice if you would like to.

Mr Grech—I will answer as best as I can, and I will fill in the gaps by putting the rest on notice. In terms of representation, we have Foreign Affairs and Trade, the Attorney-General's, AUSTRAC, Treasury and, occasionally, Prime Minister and Cabinet, so it is quite a broad membership. In terms of issues, largely it has been very much money laundering focused. Obviously, since 11 September there has been a much stronger emphasis on countering the activities of terrorist financing, under a fair bit of leadership from our counterparts in the United States. Quite frankly, in the last six months the agenda has been very much terrorist financing driven. But it is really looking at the institutional mechanisms, the regulatory frameworks et cetera across a number of countries, to ensure that they have the architecture in place to minimise the possibility of money laundering activities.

Senator CONROY—Can you confirm that the task force has released a noncooperative countries and territories list detailing those countries that have serious and systemic weaknesses in their anti money laundering programs?

Mr Gallagher—There are countries that have been identified as not being fully compliant with what are known as FATF recommendations or requirements. There are about 40 FATF recommendations that have been made which member countries are expected to comply with. If they comply with all those, they effectively get a clean bill health as being countries that have appropriate architecture infrastructure in place to combat money laundering. Some countries have been identified which do not fully comply with those recommendations.

Senator CONROY—Is Nauru one of those?

Mr Grech—I understand that it is, yes.

Senator CONROY—Are you aware of the weaknesses in the anti money laundering programs in Nauru?

Mr Grech—I am not personally familiar with the particular deficiencies in that country, but I will take that on notice if you want a more detailed answer.

Senator SCHACHT—Have any of you been to Nauru to discuss the arrangements with officials there?

Mr Grech—Treasury officials have not; I cannot answer for the work of the committee.

Senator CONROY—I understood a number of officials—they may not be from Treasury—were involved in a discussion with the Nauru government over the last six months and that these were some of the issues that were discussed. It might have been Defence doing it; it might have been Finance.

Mr Grech—The APG, which is the Asia-Pacific grouping of FATF—which is technically what we are a member of—has been doing a fair bit of work in preparation for this conference that they have in Brisbane as we speak. I would assume—and it is only an assumption, but I think it is a reasonable assumption—that there has been extensive consultation and ongoing discussion with all member countries, of which Nauru would be one.

Senator SCHACHT—Has our position in negotiating with Nauru to get an outcome to stop money laundering been compromised by the federal government's deal? Senator Conroy thought he was going to ask that question, so I will let him ask it.

Senator CONROY—I just wanted to clarify that the Australian government is aware that Nauru is on the list and that it is on the list because it is a potential place for money laundering?

Mr Grech—I would say that it is. The Attorney-General's portfolio is probably the best portfolio—

Senator CONROY—Unfortunately we only have you, Mr Grech, for the moment.

Mr Grech—That is fine.

Senator CONROY—I am sure my colleagues who are listening in the building will be drawing up some questions for them as we speak.

Mr Grech—I do not think there were any surprises in the list of countries that have been identified as countries that need to do a bit more work in coming up to the full set of standards that DFAT have specified for anti money laundering activities.

Senator CONROY—When I was referring before to Australian government officials, I was not necessarily referring to FATF. I know Australian officials have been involved in discussions about various immigration issues in the last six or eight months. Has anyone from Treasury been involved in those discussions?

Mr Grech—No, not that I am aware of.

Senator CONROY—Mr Ray?

Mr Ray—Not that I am aware of. This is outside our portfolio.

Senator CONROY—I appreciate that. I am just trying to clarify whether you were involved and you are telling me you are not.

Senator SCHACHT—You are not involved in this matter?

Mr Grech—On the immigration work, no.

Senator SCHACHT—But you are on an interdepartmental committee looking at money laundering, aren't you?

Mr Grech—On the money laundering processes, yes, but in terms of developing the government's policy position on immigration matters, that is not Treasury business.

Senator SCHACHT—I understand that, but you are intimately involved in discussions with Nauru on money laundering.

Mr Grech—I would not go so far as to say 'intimately' involved.

Mr French—That is what we are trying to point out: we are not involved.

Senator SCHACHT—Treasury is not involved! That is a contradiction in terms. You buggers have your fingers in everything. I would never accept that view from Treasury, Mr French.

Senator CONROY—That is too modest.

Senator SCHACHT—It is far too modest. Your fingers are everywhere—in every pie!

Senator CONROY—We have confirmed that you are aware that Nauru is on the list. Have you briefed the minister's office about the countries that are on this FATF money laundering list?

Mr Grech—I have not.

Senator CONROY—Has the department briefed the minister?

Mr Ray—Under outcome 1, our economic area, there might have been some briefing on this issue.

Senator CONROY—Even though this section is on the FATF are you telling me a different section would have briefed the minister's office about the discussions?

Mr Ray—The distinction is between the area of the department that is responsible for the domestic elements—Australia's compliance, the interaction with our financial institutions and those sorts of things—and the international activities of the department. For example, were the Treasurer to attend an international meeting and there was some discussion of this that part of the department would be responsible for the briefing.

Senator CONROY—You have received all this information in terms of the work of FATF and you have not passed it on to the government.

Mr Grech—No. The position is—

Senator CONROY—Mr Ray is trying to say that your section has not but someone else might have.

Senator Ian Campbell—Mr Ray said that if the Treasurer were to attend an international meeting—and I just had the experience of attending one such meeting—then he would get briefed by the relevant section of Treasury. That is exactly what happened when I attended a meeting of the IMF and the World Bank where those issues came up.

Senator CONROY—Thanks for that contribution, Senator Campbell. The work you do—the fact that a list has been established—you just sit on? There is a money laundering list and you are sitting on it in Treasury?

Mr Grech—Treasury did not compile a list of anyone who does or does not comply with various FATF recommendations.

Senator CONROY—I did not say Treasury did; FATF did. I am asking: when the list was compiled, did you communicate it to the government or did you sit on it?

Mr Ray—It would be the responsibility of another portfolio.

Senator CONROY—It is not your responsibility, after you have collected this information, to pass it on?

Mr Ray—The primary responsibility for this lies in the Attorney- General's portfolio, as we have tried to explain to you. I expect that the Foreign Affairs portfolio would be involved as well.

Senator CONROY—We previously talked to you about the context of Australia being a financial centre and we have talked to you about whether or not that position as a financial centre is compromised if there are questions about money laundering. I think we have talked to you about those issues previously. I have actually asked questions about this area previously. What I am really trying to understand is whether or not the section that received the report back in Treasury has passed it on?

Mr Grech—Australia is fully compliant with all of the recommendations of the FATF on any money laundering activities.

Senator CONROY—But you have not advised the government or your relevant minister that there is a money laundering list and who is on it.

Mr Grech—I personally have not, but I cannot speak for the Treasury portfolio on the issue. I am happy to take it on notice.

Senator SCHACHT—Mr Ray can.

Senator Ian Campbell—I can speak as a member of the government who has been briefed on the details of, as I recall, virtually every country and their level of compliance with every measure of FATE, so the government has been fully informed.

Senator CONROY—So the government is aware that Nauru is on the list, Parliamentary Secretary? You said you were briefed.

Senator Ian Campbell—I read the list on my way to Washington. There were a lot of countries on the list with their levels of compliance, and I was proud to see that Australia was, as I recall, fully compliant. There would have been many other countries that were far from

compliant. I did not actually pick up Nauru. I do not have the preoccupation with Nauru that the Australian Labor Party have.

Senator CONROY—Could you confirm, Mr Grech, that Nauru is on the list, as Senator Campbell read?

Mr Grech—If you do not mind, I would like to take that on notice. I am pretty sure that it is on the list.

Senator CONROY—Nauru is on the list and the parliamentary secretary has read the list.

Mr Ray—In general terms, I think you can be assured that the Australian government is aware of the existence of the list and who is on it.

Senator CONROY—Are you also aware that Nauru is possibly being used to launder money from terrorists?

Senator Ian Campbell—That is an issue for the Attorney-General's Department.

Mr Grech—Again, that is a matter that I am sure the FATF has been looking at, but, as I said at the outset, Treasury has not been represented on all the meeting of the APG of the FATF. We have left that to the lead agencies, which are the law enforcement agencies.

Senator CONROY—Can I draw your attention to *Hansard* of Thursday, 21 February. I actually attempted to ask Dr Parkinson some questions about Australia's involvement in FATF. Dr Parkinson in fact said:

... responsibility would be in the Financial Institutions Division, not in corporate governance and accounting, so that would be Ms Curran and Mr Grech.

He handpassed it back to you last time I asked questions on these matters.

Mr Ray—We may not be being very clear, but our responsibility is in respect of Australia domestically. We are not an enforcement agency. We are not like the United States Treasury, for example.

Senator CONROY—I am not suggesting you are. I am not asking about enforcement. I am asking about passing on information. We have actually established now that Senator Campbell accepts that the government has received the briefing and he himself has received the briefing. He has seen the list of countries that are listed and Nauru, I think is generally agreed, is one of them. Senator Campbell, are you aware of reports today that Nauru is possibly being used to launder money from terrorists?

Senator Ian Campbell—I am not aware of those reports.

Senator SCHACHT—Was Treasury aware of them in the media today?

Mr Grech—I have not read the newspapers today.

Senator SCHACHT—What about the radio?

Mr Grech—No, I have had no media exposure today.

Senator SCHACHT—You were waiting to come to estimates, so you missed all the media today?

Mr Grech—I was looking forward to it, yes.

Senator Ian Campbell—I have my press clippings and will probably read them very late tonight.

Senator CONROY—Parliamentary Secretary, do you see any inconsistency in the Financial Action Task Force, of which Australia is a member—and a lead member in our region—recommending that members apply countermeasures as of 30 September 2001 to Nauru, while Australia is providing substantial financial assistance to Nauru?

Senator Ian Campbell—I do not think they are issues that are relevant to the hearings of this committee. I can have an opinion on whatever I want, but it is not relevant to the hearings of this committee.

Senator CONROY—What is the government's view? Do you think the government views it as inconsistent to be on the one hand telling everybody else to apply sanctions, while at the same time providing money to Nauru?

Senator Ian Campbell—I do not think I need to add to the sum total of knowledge on that issue.

Senator CONROY—Do you have any knowledge on this issue that you would like to share with us at all, or are you completely ignorant of it? Was any of our financial assistance tied to improving the financial system in Nauru?

Senator Ian Campbell—You are in the wrong committee, Senator. Not only are you in the wrong portfolio, you are in the wrong committee. You are either getting very bad advice or you—

Senator CONROY—Is providing financial assistance to Nauru when they are possibly laundering money for terrorists consistent with a war on terrorism?

Senator Ian Campbell—You are crossing into the Foreign Affairs portfolio and the Attorney-General's portfolio. This is the economics committee which is considering the Treasury portfolio.

Senator SCHACHT—He is overseeing the payment of large amounts of money to Nauru. Treasury are in the interdepartmental committee and the government structure that signs off on the decisions.

Senator Ian Campbell—It is nothing to do with what is before this committee, Mr Chairman.

Senator CONROY—What will be Australia's position on Nauru's status at this month's Financial Action Task Force plenary?

Senator Ian Campbell—I know the Australian Labor Party are very fascinated and preoccupied with issues to do with Nauru. It comes under the heading not of output 3 but under the heading of 'we wuz robbed' or 'why we lost the federal election that we should not have lost.' And it still hurts, I know.

Senator CONROY—What will be Australia's position on Nauru's status at this month's Financial Action Task Force plenary?

Mr Grech—Again, as I tried to say at the outset, we have not been regular participants of the APG or IDC meetings.

Senator SCHACHT—The Treasury have not been regular participants?

Mr Grech—Treasury have not been.

Senator SCHACHT—We have not turned up?

Mr Grech—The Financial Institutions Division, on occasions with our International Finance Division colleagues, have attended some meetings. But quite frankly, in the last 12 months people in the Financial Institutions Division have been primarily focused on domestic financial matters such as insurance failures.

Senator SCHACHT—I know you have a few issues but, as I understand it, IDC meetings—or these committees at this level—do not necessarily have to meet to have a discussion; many of the meetings are in fact through the circulation of papers. On those papers I would be staggered if someone in Treasury, wanting to get their performance bonus, did not produce some comment about the papers that had been circulated from other government departments. It defies my knowledge and description of Treasury that you would not have your finger in the pie.

Mr Grech—We do try to cover all the bases.

Senator SCHACHT—I would hope so. You are the Treasury.

Mr Grech—Indeed we are, and proud of it; but we are only human.

Senator SCHACHT—Hang on! I think you will have to withdraw that—Mr Henry and the boys down at Treasury will never agree to that description!

ACTING CHAIR—Senator Schacht, give the witness the opportunity to finish his statement please.

Mr Grech—Thank you, Mr Chairman. What I am simply trying to say is that we have not attended all of the meetings. We would very much like to, but it is a question of using our resources to meet priorities. And our priorities in the last 12 months—and I make no apology for this, quite frankly—have been dealing with issues relating to HIH, UMP, medical indemnity insurance, terrorism insurance, public liability and a whole host of other things.

Senator SCHACHT—I know life's a bitch, Mr Grech, but money laundering for terrorists is a pretty important issue. I know life's a bitch and it is a bit hard at the moment, but you are all paid in Treasury to do these sorts of jobs.

ACTING CHAIR—Order! In accordance with the earlier wishes of the committee, I understand Dr Parkinson and his team have returned, so we will now call Dr Parkinson and his team to the table. We will return to outcome 3 once the matters have been concluded with Dr Parkinson's team.

Senator Ian Campbell—Mr Chairman, while we are having this interregnum, could I just get a ruling on whether the use of the word 'bitch' is parliamentary language? It strikes me that use of the word 'bitch' is unparliamentary, and I think we should have a ruling. It certainly lowers the tone of the Senate's hearings.

ACTING CHAIR—What was the context in which it was used?

Senator Ian Campbell—Senator Schacht did refer to the actions of one of the Treasury officers in terms of 'life's a bitch'.

Senator CONROY—It is a colloquialism.

Senator SCHACHT—It means 'life is tough'!

Senator Ian Campbell—It is probably a colloquialism, but I do not regard it as being appropriate parliamentary language. Could I seek a ruling from you on that?

ACTING CHAIR—I think under the circumstances it was perhaps demeaning of the Treasury officers. In that context, I think I would ask you to withdraw, Senator Schacht.

Senator SCHACHT—Come on, Mr Chairman, I did it with extreme good humour. I know that may be beyond the parliamentary secretary's—

ACTING CHAIR—Whether it was in good humour or not, I think it was an unnecessary reflection on the Treasury officers.

Senator SCHACHT—I said, 'Life's a bitch', and it is a bitch because of all the work they are doing, but there is also other important work.

ACTING CHAIR—Will you withdraw?

Senator SCHACHT—I will tell you what I will do: I will temporarily withdraw and ask the President to rule on whether 'life's a bitch'—in the circumstances I used it—is insulting to Treasury.

Senator Ian Campbell—On a point of order, Mr Chairman. I think that the senator should be asked to withdraw. Of course, it would be open for you to refer it to the President, and I would ask you to do so.

ACTING CHAIR—Senator Schacht, I ask you to withdraw. I will refer the matter to the President for her ruling.

Senator SCHACHT—If you are doing that, I will do it that way—I am not going to be difficult. I am never difficult, Mr Chairman.

ACTING CHAIR—Thank you, Senator Schacht.

Senator ALLISON—My questions relate to the revenue from T3—the proposed sale of 51 per cent of Telstra. Can you indicate to me—and I am sorry, I am not really familiar with the Treasury budget documents—where reporting of the revenue is in the outputs?

Dr Parkinson—Treasury is not responsible for asset sales. That is the responsibility of the department of finance.

Senator ALLISON—I think I understand that, but where is the revenue expected from T3 in your figures? If you have not accounted for it in these figures, that is fine.

Dr Parkinson—It will be in the net debt figures—implicitly; it will not be explicitly identified.

Senator ALLISON—Not explicitly?

Dr Parkinson—No.

Senator ALLISON—Is there some reason for that?

Dr Parkinson—It is a matter for the government.

Senator ALLISON—Parliamentary Secretary, why is it that this is not explicitly reported in the Treasury budget papers?

Mr Allen—I refer you to note 11 in Budget Paper No. 1. It is on page 12-12.

Senator ALLISON—I have the document open at 12-12.

Mr Allen—Do you see note 11 on the top of the left-hand page?

Senator ALLISON—I still cannot see any reference to Telstra.

Dr Parkinson—There will not be any reference to Telstra. My understanding is that numbers on anticipated privatisation proceeds are not explicitly identified, for commercial-in-confidence reasons, and I think that would probably be the case for Sydney airport too. But I am out of my depth on this; this is not an issue that we have responsibility for.

Senator ALLISON—What do you mean then by suggesting that the figures are in there? Where are they?

Dr Parkinson—In the sense that implicitly in the decline in Commonwealth government net debt, there must be some adjustment for the sale of Telstra and any other privatisations or surpluses and so on. But there is no line item identification.

Senator ALLISON—I understand. Without indicating what the government expects to get by way of revenue, what are the assumptions regarding retiring debt? You have made some assumptions about debt management.

Senator Ian Campbell—I think you are asking what the assumption is on the proceeds of the planned privatisations over the coming financial year.

Senator ALLISON—I do not necessarily want to know about the proceeds, but I want to know what the assumptions are in this document about how much debt will be retired—whether it is from Telstra or airports or whatever. What are the underlying assumptions? If this has been entirely canvassed before, I apologise, but it should be easy for you to answer the question.

Dr Parkinson—We were discussing it this morning. On page 2-9 of Budget Paper No. 1 there is a table. About halfway down that table in bold is 'Net debt', and across that line you will see 38.8, 34.5, 19.0, 1.8 and minus 18.9. The point that I made this morning is that you cannot read anything from that about the extent to which debt is retired. There are Commonwealth government securities on issue. You could have a net debt figure of zero if you have \$50 billion worth of government securities on issue and \$50 billion worth of assets, or you could have zero because you have retired all of your debt and you have no offsetting assets. There is nothing in this that tells you what might ultimately be done, because those decisions have not yet been taken, but it tells you that, in a net sense—taking account of all of the flows—we anticipate these net debt numbers based on the assumptions that are laid out in footnotes (a) to (c).

Senator ALLISON—In the *Age* a week or so ago there was an article written by Ken Davidson about what would happen to those moneys. The Treasurer is quoted as saying that revenue would be put into long-term issue and that a calculation has been made comparing the long-term issue returns with the profits from Telstra.

Dr Parkinson—I do not understand what is meant by 'revenue is put into long-term issue'.

Senator Ian Campbell—Could we have a copy of that article?

Senator ALLISON—Yes.

Dr Parkinson—Without having seen exactly what Mr Davidson has said, what the Treasurer had said is that, when we issue debt, we are issuing into long-term government debt. So we are issuing at the 10- to 13-year mark.

Senator ALLISON—The general thrust of that article is that the proposals the government is suggesting for retiring of debt or of investing that money in long-term issue, whatever that is, will yield considerably less than the annual profits available from Telstra.

Dr Parkinson—I am not in a position to answer a question related to the profits or otherwise of Telstra.

Senator ALLISON—I find that a bit hard to understand. It is public knowledge what the profits of Telstra are. This is not some commercial-in-confidence figure. The profits are \$2 billion a year—or have been for the past two years.

Dr Parkinson—It is quite true that it is public knowledge what Telstra profits have been in the past, but if you can tell me what they are going to be in the future—

Senator ALLISON—I am not asking you what they are going to be in the future. But you can make some assumptions. You can say that the profits are likely to grow by four or five per cent over the next few years. That is the sort of assumption I would expect you to make.

Senator Ian Campbell—Not if AAPT and Virgin Mobile have their way.

Senator ALLISON—We will see.

Dr Parkinson—Senator, with respect, you are asking me to talk about issues that do not go to the heart of the Treasury's responsibility. If you wish to talk about privatisation proceeds of Telstra, and Telstra's profitability, then please take that up with the department of finance.

Senator ALLISON—I am asking you about debt management and about that comment, which goes to the question of debt management, as I said.

Dr Parkinson—Okay, then can I refer you to the top two paragraphs on page 7-4 in Budget Paper No. 1:

The reduction in Commonwealth net debt has raised questions by some market participants about the future viability of the CGS market. The Government acknowledges these concerns and is carefully considering them, taking the views of key stakeholders into account.

While the Government considers these issues, it will continue the approach to debt management adopted in recent years. This strategy has been aimed at maintaining the length and efficiency of the yield curve and maintaining liquidity in key benchmark stocks.

If you juxtapose that with the portfolio budget statement, where—Mr Davidson's article points out—it says that the Commonwealth will be issuing long-term debt not retiring it, what this is highlighting is a distinction between gross debt on issue and net debt on issue. At the moment, because the government has made no decision in terms of how to respond to those concerns of key stakeholders, it is running a policy that says it wants to maintain the efficiency and viability of the Commonwealth government securities market. To do that, it is issuing long-dated bonds.

To give you an example off the top of my head, Commonwealth net debt has fallen from \$105 billion to \$65 billion since 30 June 1997, yet Commonwealth government securities on issue have fallen from \$79 billion to \$53 billion or thereabouts. That is just highlighting the fact that there are differences between Commonwealth government securities on issue, gross Commonwealth debt and net Commonwealth debt. You could have net Commonwealth debt falling while you were maintaining Commonwealth government securities on issue unchanged if you were to accumulate financial assets. Because there has been no decision made about the future of the Commonwealth government securities market, nor about whether the government is going to accumulate significant financial assets, the budget papers talk in net debt terms. So Mr Davidson has focused on the decline in net debt and has juxtaposed that with the fact that the Commonwealth is continuing to issue securities at the

long end of the market to maintain efficiency of the market. He has brought those two things together in this paragraph that you have circled for us.

Senator ALLISON—As you suggest it is not your job to do it, would you suggest that that should be forwarded to Treasury for their analysis of the figures presented?

Dr Parkinson—To be forwarded to Treasury or Finance?

Senator ALLISON—Whoever you think is the appropriate agency.

Dr Parkinson—If you want information on Telstra and the potential privatisation proceeds, it should definitely go to Finance.

Senator ALLISON—That is not my question.

Dr Parkinson—Forgive me, but I am struggling to understand what it is that you are asking me.

Senator ALLISON—Perhaps it is a question for the minister. Minister, do you expect to have all of this sorted out before there is a serious proposition put forward to parliament?

Senator Ian Campbell—I think the question is: if we sell Telstra, can we still have some debt out there in the marketplace? That is the conundrum, isn't it? The issue, and we had a long talk about this earlier today, is that the government is now facing the challenge and the opportunity of moving into an era that we have not enjoyed for a long time—that is, of having no net government debt. Through surplus budgets over a period of six, seven or eight years and assets sales, we will have got Australia out of government debt. We will then have to deal with the issues of what happens when you go back into the black, basically.

Senator ALLISON—And then? Does that suggest that you would sell Telstra prior to understanding what the long-term balance sheet is?

Senator Ian Campbell—It is a very good problem to have. The issue we are really dealing with here is that there is a bunch of people, predominantly in Sydney, who make a big living from dealing in these debt instruments that the Commonwealth issues. The more bond issues, the more bits of paper the Commonwealth puts into the market, the more they have to play with and make commissions from—that is the core of the issue. They want the Commonwealth to issue paper. We are now dealing with the issue as to whether we think it is a good idea or not. There are arguments on both sides as to whether we should have debt out there. Regarding the consultation process, we have said that we will consult with key stakeholders. Senator Conroy is suggesting that we may want to go wider with that consultation—that is what is before the Treasurer at the moment.

Senator ALLISON—Who would you identify as key stakeholders?

Dr Parkinson—Off the top of my head, and this is not meant to be exhaustive, clearly you would want to involve the superannuation funds as purchasers of Commonwealth debt. You would need to involve the financial market intermediaries: the people with interest in the market. But you would need to go beyond that I would think. You would need to involve people who have the interests of shareholders at stake. Senator Conroy suggested that there were broader groups and I am sure that there are many broader groups whom we would want to consult.

Senator ALLISON—How long will that process take?

Dr Parkinson—As Senator Campbell said, we discussed this with Senator Conroy this morning. I can tell you that we have a proposal before the Treasurer as to how the

consultation process might work. That is a decision for the government to take and then we would hope to be able to start consultation fairly quickly. The other thing is that, in contrast with some of the views that have been put domestically, international investors in discussions with me have not insisted that the government make a decision soon. They want to know that the government is considering the issue. They want to know that we have a process in place that is bringing the relevant information together.

Senator ALLISON—Their parliaments are not interested in the question of whether, at the end of the day, retiring debt and privatisation are going to affect the bottom line. Is that what you are saying—trusting government to get it right?

Dr Parkinson—Sorry, I do not see how you could draw that from what I just said.

Senator Ian Campbell—It is not an issue about the bottom line; it is an issue about whether or not the Commonwealth has a debt portfolio, even though we have no net debt.

Dr Parkinson—As I said this morning, you could end up with zero net debt, but still have \$50 billion worth of Commonwealth government securities on issue and \$50 billion of accumulated financial assets. They could be used for a variety of things. They could be hypothecated to superannuation or used in other ways.

Senator ALLISON—Thank you. That completes my questions.

Proceedings suspended from 12.30 p.m. to 1.21 p.m.

ACTING CHAIR—Senator Conroy, I understand you have further questions for the Australian Office of Financial Management, and then we will proceed to outcome 3.

Senator CONROY—How does AOFM expect to manage the portfolio as it shrinks in response to the debt repayment over the forward years? Has any thought been given to splitting the portfolio into two parts with one part earmarked for debt repayment, as UBS recommended in 1998?

Mr Allen—In our discussions back in March, the last time we appeared before the committee, we ran through a number of issues broadly around this question. Without trying to pre-empt what further questions you might be looking to ask, I think it is difficult to answer that question in isolation. Having said that, we manage the debt portfolio on a net basis and we manage the risks on a net basis. We see that as being the appropriate way to manage the portfolio. As part of our management deliberations we do spend quite a bit of time thinking about the different impacts that are influencing the different risk profiles of the portfolio. Part of our benchmark review, it is fair to say, is looking at this issue—not so much along the lines that UBS were suggesting, but looking at what is driving the change in the risk profile of the portfolio and how we should best manage those outcomes.

Senator CONROY—You looked as if you were going to say something, Dr Parkinson.

Dr Parkinson—No.

Senator CONROY—I was anticipating your contribution. So you are looking at similar management measures?

Dr Parkinson—Similar outcomes.

Senator CONROY—What will be the impact of interest rate rises on the cost of servicing government debt managed by AOFM? I recall the submission, Mr Allen, that I think you put into the JCPAA in May 2000, in which you stated that a 0.5 per cent increase would add approximately \$1.1 billion to government debt. Is that figure correct?

Mr Allen—I do not have those figures in front of me. I would have to be reminded of that table, but the \$1.1 billion number may be a little high.

Senator CONROY—I have a few notes on it, but you can have a quick look. I would like to get it back. I am not tabling it; I will just pass it over to you.

Mr McCray—Did you say it would lead to an increase in the cost of debt?

Senator CONROY—That a 0.5 per cent increase in interest rates would add to government debt.

Mr McCray—It would reduce the market value of debt.

Senator CONROY—I am just looking at the submission from Mr Allen.

Mr Allen—That particular table—and, again, we have to be reasonably careful in terms of the definitions that we are using here, as well as in terms of the signs—showed that the net change on the portfolio due to a movement in interest rates was in the order of \$1.1 billion. Obviously, given that we are a liability manager, if interest rates go up, it therefore reduces the market value of our liability. In that table, the market value reduction was in the order of \$1.1 billion

Senator CONROY—That is a cost to the taxpayer?

Mr Allen—No, if interest rates rise, with our liability portfolio that is a benefit to the taxpayer.

Mr McCray—It is a reduction in the market value.

Senator CONROY—Yes, but you have floating rate swaps. Cut it out!

Mr Allen—That is true. As I just mentioned, we need to be careful about the definitions of (a) the measures and (b) what we are trying to measure. That particular table gives you an outline of the change in the market value of the portfolio. Again, we went through a number of issues with respect to the valuation of the portfolio, the present value analysis and the like back in March. There are a number of ways of looking at this issue.

Senator CONROY—I just want to look at it the way you looked at it before.

Mr Allen—What we said is that an increase in interest rates would lead to the market value of the portfolio—and I think, if you look at the top left-hand corner, the numbers you were working from were in the order of \$64 billion—reducing by in the order of \$1.1 billion.

Senator CONROY—So the impact of swapping \$30-odd billion of the portfolio to floating swaps has not been affected by interest rates going up? That is a novel proposition.

Mr Allen—No, we are not saying that at all.

Dr Parkinson—Before we go too far down this route, we talked at our last meeting about why we were engaged in interest rate swaps. It was to smooth the impact on public debt interest, and so we would lose on one side and gain on the other. But we were stabilising it, so essentially we were managing the risk, where risk is interpreted in terms of volatility of PDI.

Senator CONROY—I appreciate that you are attempting to smooth, but you have jumped out of fixed into floating at a time when interest rates are going up.

Dr Parkinson—Sorry, Senator, but—

Senator CONROY—That is what has happened: you have swapped. That is actually what happened, Dr Parkinson. The documents actually show that AOFM have moved out of fixed into floating.

Dr Parkinson—We are required to manage the debt portfolio from a long-term perspective, and so the approach is to smooth the risk of the portfolio. To say that because interest rates have gone up it is silly is just as baseless as saying that because interest rates are going down it has been a brilliant policy. It is actually about smoothing risk over time.

Senator CONROY—I appreciate that that is the intention of the strategy, but any mug punter—

Dr Parkinson—So you accept that it is a valid strategy?

Senator CONROY—I get to ask the questions.

ACTING CHAIR—I think it is—

Senator CONROY—I am sorry, Acting Chair, but I get to ask the questions. They do not get to ask me questions and have you tell them they can.

ACTING CHAIR—It does help them in terms of their response, Senator Conroy, if they know the perspective that you are coming from.

Senator CONROY—I know exactly what Dr Parkinson is trying to do. But the bottom line here is, as part of the strategy that you have employed, you have swapped \$30 billion at fixed into floating at a time when interest rates have moved up. Therefore, there has to be an increase in cost to the taxpayer. It may be in the long run that that does not matter, as you are trying to postulate, Dr Parkinson, but right now, on Mr Allen's own figures, taxpayers are \$1 billion worse off because of the strategy.

Senator Ian Campbell—That is simply not true.

Senator CONROY—Please, do not embarrass yourself.

Senator Ian Campbell—That is simply not true.

ACTING CHAIR—Order!

Senator CONROY—You have stock over here at a fixed rate.

Senator Ian Campbell—Last time this estimates committee—

Senator CONROY—You put \$30 billion over here into floating and it goes up.

ACTING CHAIR—Just a moment, Senator Conroy, you have had your say. The parliamentary secretary is attempting to give you an answer.

Senator CONROY—No, he is not.

Senator Ian Campbell—This senator made an assertion last time this committee met to discuss foreign currency issues and swaps that the taxpayer was \$5 billion worse off. That has been comprehensively proven to be totally fallacious. This assertion is identical.

Senator CONROY—Do you get embarrassed when you tell people that?

Senator Ian Campbell—Senator Conroy always goes a bridge too far. He went a bridge too far with his foreign currency swaps, and now he is seeking to exaggerate in relation to interest rates. He will not listen to the facts put forward by the Treasury officials. He wants to get a line up, but I warn members of the public and journalists to look very carefully at this

senator's maths because he has proven himself wrong last time this committee met, comprehensively, and he is seeking to do it again. It is deliberately misleading.

ACTING CHAIR—Now can we have an answer from Mr Allen?

Mr Allen—Stepping back to my earlier comment, it is important to make sure we are talking about, and have the definitions with respect to, either what question we are asking or what answer and the context of that answer.

Senator CONROY—You can put it in any context you would like to put it in. I am putting it in the context of the cost to the taxpayer right at this moment.

Mr Allen—The objective that we manage the portfolio within is meeting duration within a three to 3½ target range. That is one portfolio management objective. There are a number of implications of trying to manage within that benchmark target range and effectively, by targeting that 3¼ duration, what we are really saying is that we are spreading our interest rate risk over a particular period. If you look at the details of our portfolio, it is over a 10- to 12-year period. If you could imagine our stock of debt, it is effectively spread out over those particular years. There are a couple of notions that fall beneath that that are important to look at.

One notion is the market value change of that debt portfolio, and we could provide updated numbers to those that we presented to you some months ago—they do change as a consequence of a change in interest rates. If interest rates move up, the market value of the portfolio—if the taxpayer had to repay that debt portfolio today—would be a reduced number than what it would be prior to the interest rate increase. The other notion is in terms of changes to the underlying cost. Obviously, as I have said before, maturities are spread over a 10- to 12-year period, so a change in interest rates is going to be dependent upon the amount of resets that you have coming up over the life of the portfolio. There are a number of different ways in which you can look at trying to quantify the question that you are asking. But if you ask the question: what does the market value of the portfolio do?, the market value of the portfolio—the liability, the future value that the Commonwealth has to pay—reduces as a consequence of interest rates going up.

Mr McCray—The task of managing the portfolio, as Dr Parkinson referred to, in the sense of smoothing impacts over time, is essentially about striking a balance between fixed and floating exposure in the portfolio, which manifests itself in the way we manage the portfolio in this duration target. We could reach this duration target through entirely issuing physical securities or through a combination of issuing physical securities and interest rate swaps. We do not isolate the interest rate swaps and look at the value of that particular book and wonder whether it was a good or bad decision; we are managing a portfolio using two tools: physical securities and interest rate swaps. The way to look at the impact on the portfolio of a given movement in interest rates is to look at the aggregate movement and, as Mr Allen says, if interest rates rise, the market value of the portfolio declines. Using interest rate swaps in addition to just issuing physical securities offers us a number of additional debt management advantages. There are net benefits in using interest rate swaps in the portfolio management task. The question you are coming to really is about the duration target.

Senator CONROY—No, probably not. I am about to ask you: are debt servicing costs higher today than they otherwise would have been as a consequence of this policy?

Mr Allen—I do not think you can argue that necessarily. As we talked about at some length back in March—

Senator CONROY—The answer is yes, isn't it, Mr Allen?

ACTING CHAIR—Order! Come on, Senator Conroy!

Mr Allen—by virtue of the Commonwealth having a debt portfolio, we are subject to interest rate rises and—

Senator CONROY—So if interest rates go up half a per cent, debt servicing is higher than it otherwise was. It is a yes or no question—and you know that, Mr Allen. I appreciate all the other points that you are trying to make, but the answer to my question is?

Mr Allen—In the sense that we benefit by interest rate decline, we also lose by an interest rate increase.

Senator CONROY—Thank you.

Mr Allen—But I think it is very important not to then make a direct link between a particular value. One then has to look at—

Senator CONROY—But your own figures show that higher debt service outweighs the fall in the value of the debt, so let us just stop.

Mr Allen—No, if you are going back to refer—

Senator CONROY—That is your maths.

Mr Allen—to that \$1.1 billion, that is a present value measure which relates to the life of the portfolio. It does not look at the debt service cost.

Mr McCray—It is the market value of the stock, not the flow in relation to that stock.

Senator CONROY—The fundamental position is that, when interest rates are, as the Treasurer says, historically low, you swapped into floating at a fixed. At a probable historic low—an assumption is that they may go up; if they are historically low, they still could go down—you swapped \$30 billion out of fixed into floating. That is why there is an increased cost.

Mr Comley—Can I just add something here. I think it is germane to your point. We would want to be very clear that the AOFM did not suddenly swap \$30 billion into—

Senator CONROY—It had a smoothing strategy.

ACTING CHAIR—Order!

Mr Comley—It did not do it suddenly just now or over the last year. In fact, on the AOFM web site there is information as to the total swap portfolio that has been built up, and that indicates fairly clearly that the major build-up in the outstanding swap portfolio occurred from the middle of 1997 until June 2001. Without getting into a precise analysis of what the average interest rate those swaps were entered into or swapped at, it is not clear that they were all entered into at the current interest rates. In fact, almost certainly, most of them were entered in at a time when interest rates were higher.

Senator CONROY—That is what you are hoping, Mr Comley.

ACTING CHAIR—That is what happened.

Senator Ian Campbell—It is on the record what the interest rates were in 1996. It is on the record what the debt portfolio was that we had to manage in 1996, when we came to power. We inherited \$96 billion after 13 of the most disastrously economically managed years in Australian economic history and we inherited record-high interest rates. It is now a matter of

economic record that those interest rates were higher then and they have come down. It is not a matter of hoping.

Mr Comley—I wanted to make an observation. I think the senator is asking what happens to the cost to the Commonwealth with a change in interest rates. Mr Allen commented that the stock of debt value moves in the opposite direction to the interest rate movement but that the cost of servicing and floating rate exposure moves in the same direction as the interest rate payment. To form an assessment as to whether the policy as a whole of entering into swaps has been ex post facto beneficial to the Commonwealth or not would require going back and looking at the time at which each of those swap transactions were entered into.

Dr Parkinson—You would want to wait and see over the entire life of the program.

Senator CONROY—I appreciate you are running the same defence you ran last time, Dr Parkinson and Mr Comley.

Dr Parkinson—I am afraid that you use the word ‘defence’. To me, it is fact or truth.

Senator CONROY—You may be aware that the RBA Governor appeared before the House economics committee in Sydney last Friday.

Dr Parkinson—Yes.

Senator CONROY—In its press release of 4 March 2002, the RBA said it first became aware in mid-2002 of the AOFM’s plans to make early repayments of US dollar debt to avoid breaching the 15 per cent limit on currency exposure. The governor confirmed that this was May 2002. Does that accord with your recollections?

Dr Parkinson—That is the case; but I think we made clear the last time around that there were officer-to-officer discussions in May. If you go on, you will recall that the governor also said on Friday that he was not particularly worried at the time because AOFM was not in the position of having to close out any swaps; there were none maturing.

Senator CONROY—Thanks.

Dr Parkinson—I am just trying to be helpful.

Senator CONROY—As always. The press release of 4 March 2002 seems to suggest that the RBA did not get in contact with anyone in the government until October 2002.

Dr Parkinson—October 2002? I am afraid that at the moment it is only July 2002.

Senator CONROY—Sorry, 2001. Thank you for correcting me on that.

Dr Parkinson—I think that is actually not what the press release says either.

Senator CONROY—I have got a copy of it here.

Dr Parkinson—The governor got in contact with the secretary in I think October—

Senator CONROY—I said ‘government’ rather than ‘secretary’. On 5 October—

Dr Parkinson—Then the governor spoke to the—

ACTING CHAIR—Order!

Senator CONROY—If I could finish my question, that might help us both.

ACTING CHAIR—Dr Parkinson, can you clarify that?

Dr Parkinson—I think the date that the governor spoke to the Treasurer for the first time on the issue was 10 November 2000.

Senator CONROY—The press release says—

ACTING CHAIR—Which date?

Senator CONROY—The press release of 4 March 2002. It says:

On 5 October, I wrote to the Secretary to the Treasury.

Dr Parkinson—And as we said last time: on 17 October 2000, in response to a request from the governor, the former secretary agreed to a temporary breach of the benchmark; on 9 November 2000, the Treasurer was advised by us there was an issue concerning operation of the benchmark; and on 10 November, at a Reserve Bank board debriefing, the governor, the Treasurer and the secretary discussed the matter.

Senator CONROY—You probably jumped ahead of me in terms of where I was at in my questions.

Dr Parkinson—I wanted to get the dates on record.

Senator CONROY—I am happy to table the Reserve Bank Governor's—

Dr Parkinson—There is no inconsistency.

Senator CONROY—I was not suggesting—from what I have said so far—that there was. If I could finish my question then we will move a bit faster. As I was saying, the press release on 4 March 2002 seemed to suggest that the RBA did not get in contact with anyone in the government until October 2000—that should be, I think. However, the governor said in the hearing on Friday that he spoke to the Secretary to the Treasury in June and on several subsequent occasions. Were you aware of these conversations?

Dr Parkinson—Both secretaries and governors always speak on a regular basis.

Senator CONROY—Yes, but he spoke specifically on this issue. In his testimony last week that is what he said.

ACTING CHAIR—You might have to ask the Secretary to the Treasury then.

Dr Parkinson—It is the former secretary. I do not see that there is any issue here, in a sense. On 5 October 2000 he formally raised the issue with the secretary.

Senator CONROY—He said on Friday that he spoke with the secretary in June and on several subsequent occasions. Were you aware of those conversations?

Dr Parkinson—I personally was not.

Senator CONROY—Did the Secretary to the Treasury speak to you about the government's concerns?

Dr Parkinson—Again, I can say that I personally did not.

Senator CONROY—Just to clarify: at that point in time, were you in charge of this section?

Dr Parkinson—No, I was not in the country.

Senator CONROY—Who was in charge?

Dr Parkinson—The current secretary. Can you tell me which page number you are referring to? It is EFPA 23?

Senator CONROY—I will take your word, I do not have the exact annotation but I can happily track it down for you.

Dr Parkinson—No, that is okay. Mr Griffin asked:

In early June you raised it with the Secretary of the Treasury. You believe you raised it again with him several times in the following four months. Then at about that four-month time you wrote to confirm a request from him effectively to you to seek advice in writing?

Mr Macfarlane responded:

He was feeling uncomfortable that this ratio was going over 15 per cent. He knew I was saying: just let it. He felt that he ought to have something on paper more than just his verbal agreement with me to be able to explain after the event why he had allowed it to go above 15 per cent. So that is when I wrote that letter.

That is the governor's description of discussions between him and the previous secretary. I cannot add anything.

Senator CONROY—Mr Allen, were you made aware by Dr Henry of his conversations with the governor about his concerns with AOFM's activities?

Mr Allen—I honestly cannot remember specific conversations with Dr Henry or the then secretary.

Senator CONROY—I would have thought that if the boss came and knocked on your door and said, 'Mr Allen, I have just had a call from the Governor of the Reserve Bank; he is a bit concerned about what you are up to,' I would remember that.

Dr Parkinson—We did a fairly comprehensive search through all of our files in preparation for our last discussion, and I do not recall us finding any evidence that there was a formalised contact. But, as I have said before, at officer level there were ongoing discussions and one of the Reserve Bank officers raised the matter with the governor. The governor may well have raised it with the Secretary to the Treasury.

Senator CONROY—He does say he had verbal contact.

Dr Parkinson—He says he did, and I have no reason to doubt his comments, but he did not formally raise it until 6 October.

Senator CONROY—We are in heated agreement for once, Dr Parkinson. Mr Allen, did the RBA at any time contact AOFM directly?

Mr Allen—As we indicated, there were discussions and those discussions happen on a regular basis with the RBA about a whole range of issues.

Senator CONROY—Did they raise this issue with you directly?

Mr Allen—At the officer level we had discussed what we thought our activities might be with respect to our FX exposure. Obviously it is part of our portfolio monitoring and risk management processes internally. This issue, at the officer level, was discussed on a regular basis.

Senator CONROY—On this issue specifically could you give us a time line of when the Reserve Bank contacted you directly about this issue. I am happy for you to take it on notice.

Dr Parkinson—We are happy to take it on notice, but I am not sure that we are going to be able to tell you anything more than we have already told you.

Senator CONROY—I am just interested in the dates, that is all. I am not trying to put Mr Allen on the spot with his memory. I appreciate it was a long time ago.

Mr Allen—We can be reasonably specific: there were discussions in the month of May. We have, effectively, a quarterly meeting with the bank and that was one of the meetings that we had.

Senator CONROY—And then there were ensuing discussions.

Mr Allen—There were similar discussions earlier in the year. I am not sure whether in that year it was in February that we had the previous meeting with the bank.

Senator CONROY—To save time now, could you just check the records and let us know.

Mr Allen—I am happy to say that there were discussions in May.

Senator CONROY—I thought you said there were discussions prior to May, as well—in February.

Dr Parkinson—We are happy to take it on notice.

Senator CONROY—Could you look through the minutes of any discussions you have had and see if it came up. The Reserve Bank Governor was asked on Friday whether the government's debt management activities posed any further risks to currency stability. He responded by saying, 'If there is no US debt there can be no impact on the dollar.' What is your view?

Dr Parkinson—I think the governor said, at another time in his discussion on Friday, that something was 'bleedingly obvious' and I think that falls in the same category.

Senator CONROY—So there is still substantial US debt.

Mr Allen—If there is no foreign currency exposure there can never be any exchange rate impact.

Senator CONROY—There is still substantial US debt at the moment, isn't there?

Mr Allen—There is still a proportion of the total portfolio that is denominated in US dollars.

Senator CONROY—So, by implication, the government's debt management activities still pose a risk to the Australian dollar.

Mr Allen—I would disagree with that entirely but if you would like to take that up with the governor I am sure he would be happy to discuss it with you. To be fair, I think the governor also said that why he was worried about it at the time was that it was an environment of falling exchange rate and quite thin markets.

Senator CONROY—I would like to ask about outstanding currency exposure in the Commonwealth portfolio. The annual report for 2000-01 shows, on page 39, that foreign currency exposure was \$13 billion or 20.6 per cent of the total debt portfolio of \$63.2 billion, as at June 30 2001. I think that is from your annual report. What is the current market value of the Commonwealth portfolio?

Mr Allen—In our portfolio budget statements the current carrying value for the swap portfolio is outlined.

Senator CONROY—I am asking about that whole Commonwealth portfolio.

Dr Parkinson—I do not think there is any problem telling you this: on 24 May the market valuation was around \$10.8 billion.

Senator CONROY—That is the whole Commonwealth portfolio?

Dr Parkinson—That is the market valuation of the foreign currency portfolio.

Senator CONROY—On 30 June 2001, I thought it was \$63.2 billion. I hope we have not lost that much money.

Dr Parkinson—I am sorry; I misunderstood what you were asking.

Senator CONROY—I will be coming to a couple of the categories in a minute.

Dr Parkinson—At 24 May, Commonwealth owned debt was a bit under \$62 billion, of which the foreign currency component is about \$10.8 billion. And US dollar exposure makes up most of that. There is a little residual sterling.

Senator CONROY—You can help me with some quick maths or you may have the figure handy. What is the foreign currency exposure as a percentage of the total portfolio? On June 30, 2001 it was 20.6 per cent.

Dr Parkinson—It is lower than that. At 24 May it was about 17½ per cent.

Senator CONROY—You mentioned that it is almost all US but for residual sterling.

Dr Parkinson—There is a residual amount. It is quite small; I think it is about \$170 million.

Senator CONROY—What instruments comprise the foreign currency exposure? At 30 June 2001 the \$13 billion comprised \$0.5 billion loans and \$12.5 billion of non-derivative cash flows. Has that changed?

Mr Allen—The proportion has not changed. Obviously there has been a reduction in the total, due to our run down in the FX swaps.

Senator CONROY—The 2000-01 annual report, at footnote (f) on page 56, states that non-derivative cash flows comprise ‘forward foreign exchange contracts, cross currency swaps and interest rate swaps’. Could you tell me the breakdown in exposure to each of those instruments now and as at 30 June 2001?

Mr Allen—I would be happy to provide that information. We can take that on notice.

Senator CONROY—You do not have it handy?

Dr Parkinson—We will take it on notice. That is probably best.

Senator CONROY—I am willing to bet that the latter figure of 2001 is probably zero, but I am interested in where you are at on that.

Dr Parkinson—What is the reference to ‘zero’?

Senator CONROY—How much is forward foreign exchange contracts—I am willing to bet they were about zero early on.

Mr Allen—We can provide you with that detail.

Senator CONROY—I would like to talk about maturities in cross-currency swaps in 2001-02. Can you confirm that no new currency swap contracts have been entered into during 2001-02?

Mr Allen—Yes. As we explained in March, we have been engaging in FX forwards with the Reserve Bank to smooth out the existing maturity profile. Again, I would be careful in terms of the definition—but yes is the answer.

Senator CONROY—The Treasurer, speaking on the *7.30 Report* on 7 March 2002, said that the government was winding down its currency swaps as it has been over the course of the year. To what extent has currency swap exposure been wound down over 2001-02?

Mr Allen—We have not been publicly disclosing that information. We have indicated that that run-down is happening on an orderly basis over a medium- to long-term horizon. Obviously those numbers would be updated.

Senator CONROY—I might rephrase that and come back to you. How many individual cross-currency swap contracts matured in 2001-02?

Mr Allen—We can provide that on notice.

Senator CONROY—What was the notional value of those contracts in Australian and US dollars? If there is a problem, please say.

Mr Allen—The information is publicly available, so we can provide that on notice.

Senator CONROY—What was the spot exchange rate for when the contracts mature?

Mr Allen—That would depend upon the time of the year.

Senator CONROY—You would be able to give us that? I presume it is written into the contracts.

Mr Allen—That is very transparent; that is publicly available.

Senator CONROY—What was the realised gain or loss on these contracts?

Mr Allen—Under our AAS 31 measure, if you look at portfolio budget statement table 3.7, ‘Net foreign exchange gains’, you will see that, for the year, based on the budget estimates—

Senator CONROY—I am talking about realised and not unrealised gains or losses. I want to stress that.

Mr Allen—Again, that depends on which measure you look at. From the perspective of AAS 31, there has been a gain this financial year of \$557 million. That was based on budget estimates.

Dr Parkinson—That was based on an exchange rate of around 53c.

Mr McCray—Of that figure, I think \$126 million is realised gain.

Senator CONROY—Can I clarify: I was talking about 2001-02.

Mr McCray—Yes, that is correct.

Senator CONROY—What is the maturity profile of outstanding cross-currency swap contracts?

Mr Allen—For the remaining period?

Senator CONROY—If that is confidential or a problem, that is fine.

Dr Parkinson—It is commercial-in-confidence.

Senator CONROY—I may come back to you on that in a different way. It is a substantial exposure, though?

Dr Parkinson—It is \$5.7 billion. As you would recall, it was between \$6½ and \$7 billion previously; it is now about \$5¾ billion.

Senator CONROY—Will contracts be closed out or will they simply be allowed to mature?

Mr Allen—As we have already pointed out on the public record, we will look to smooth the impact of the existing maturity profile. So it is a combination of both. At times, it will be by way of maturities in the portfolio. At other times, we will offset some of the impact of the maturity by taking forward contracts with the Reserve Bank. It is a combination of the two.

Senator CONROY—When does the last swap mature?

Mr McCray—November 2008.

Senator CONROY—So government liabilities will be exposed to foreign currency risk until the last cross-currency swap matures in 2008?

Dr Parkinson—That was the point we were making at the last meeting. And because of that you cannot actually reach a conclusion about the sense of the policy until you look at it in a lifetime sense.

Senator CONROY—I would like to return to the RBA Governor's comments when he was asked whether the government's debt management actually exposed any further risk and he responded by saying, 'If there is no US debt there can be no impact on the dollar.'

Dr Parkinson—Can you tell me which page in the transcript that is?

Senator CONROY—I will chase that up for you. I thought you had it before. I am just quoting the same thing again. I thought you had found it when you were looking through your—

Dr Parkinson—No, I found the one about—

Senator CONROY—You found the one you had marked?

Dr Parkinson—No, it was not quite that simple. It was the one about when he spoke to the Treasurer.

Senator CONROY—I am attempting to find the actual page reference for you, Dr Parkinson.

Dr Parkinson—Thank you.

Senator CONROY—I want to talk about the use of forward foreign exchange contracts. Have any contracts of any type been entered into in 2001-02 that established any new exposure to foreign currencies?

Mr Allen—No new net exposure to foreign currencies.

Senator CONROY—'Net exposure'—what does that mean? Disaggregate that for me.

Mr Allen—It means that, in order to smooth the maturity profile of the existing portfolio—for example, in the month of May we may have had an \$800 million cross-currency swap mature. Our judgment may tell us that we only want to reduce the foreign currency swap portfolio by \$700 million in the month of May. Looking forward to the month of June, where we have no maturities, we may make the judgment that it would be better to have the \$100 million of foreign currency of that swap actually mature in the month of June, so it smooths out the transactional impact on the financial market. In order to achieve that objective we would engage in a forward foreign exchange swap with the bank to effectively transfer the maturity of that \$100 million into the month of June, thereby achieving our objective of having our profile run down on an orderly basis over time.

Senator CONROY—So you have been introducing new exposure to foreign currency. You said ‘net’ before, and for net the answer is no. I am talking about individual contracts now, not the net position.

Dr Parkinson—There are individual contracts with the Reserve Bank.

Senator CONROY—Have any forward foreign exchange contracts been entered into which established new exposure to foreign currencies?

Mr Allen—Not on a net basis, no.

Senator CONROY—‘Not on a net basis’—which means yes.

Senator Ian Campbell—Net is the only basis that you can possibly sensibly quantify it.

Senator CONROY—If you want to cover it up, yes.

Dr Parkinson—Senator! I—

ACTING CHAIR—Order!

Senator Ian Campbell—Could I just make a point, Senator Watson. In case the irony has not struck anyone else in this room, this sort of examination of how this Commonwealth government is getting rid of a problem that was caused by Labor’s financial vandalism of the eighties and nineties is analogous to Alan Bond cross-examining those who were trying to recover the lost amounts from his empire. It is quite bizarre. And this senator will not accept the facts being put before him by the Treasury officials.

Senator CONROY—We are running short of time, Senator Watson.

Senator Ian Campbell—They talk about exposure and he wants to slice credibility fine on whether it is net or not. When it comes to exposure there can only be a net exposure.

ACTING CHAIR—Thank you. Senator Conroy, I think those comments could be taken as a personal reflection on Dr Parkinson, because you used—

Senator CONROY—No, I was responding to Senator Campbell, so there was no reflection at all on the officers.

ACTING CHAIR—You were referring to Dr Parkinson, and I suggest—

Senator CONROY—Senator Campbell interjected and I interjected in response to Senator Campbell.

ACTING CHAIR—Prior to that, there was a reference about a cover up to which I think Dr Parkinson appeared to take offence.

Senator CONROY—If you check *Hansard*, that was in response to—

ACTING CHAIR—So in terms of that incident, I ask you to withdraw.

Senator CONROY—I ask you to go and consult *Hansard* because *Hansard* will demonstrate that Senator Campbell interjected over the top of Dr Parkinson and made a number of politically motivated comments, and I interjected in response to Senator Campbell’s rude interruption of Dr Parkinson. So my comments were not—and *Hansard* will bear this out—in any way in response to anything Dr Parkinson said. I was responding to the rude interruption of Senator Campbell over Dr Parkinson.

ACTING CHAIR—Is that the way you interpret it, Dr Parkinson? Let us clear this up.

Dr Parkinson—I interpreted it as a reference to the work of the AOFM and Treasury.

ACTING CHAIR—If that is the case, I think it should be withdrawn.

Senator CONROY—I will happily withdraw it.

ACTING CHAIR—Thank you. Next question.

Senator CONROY—I was asking about foreign exposure. As the swaps have matured, you have taken out new exposure through forwards. That is just a fact; that is what ‘forward’ is.

Mr Allen—As I have said before, we do engage in forward but they are not increasing the net exposure of the portfolio. All we are doing is transferring from one period to another.

Mr McCray—We have used the terms ‘a defined, orderly, rundown schedule’ on a number of occasions here. Swaps, of themselves—in their maturities—do not run off in an orderly fashion; they are lumpy. The forward foreign exchange contracts are used to smooth that lumpy profile; they do not generate any new exposure.

Senator CONROY—Unfortunately, I think the problem here is not actually your terminology. I think the problem here is that the Treasurer has said that he has ended the policy but what in actual fact is happening is that that is not true. The problem here is the Treasurer’s statement, because what is actually happening is you are using forwards to maintain currency exposure whereas he is trying to give the impression he has stopped it.

Dr Parkinson—I think that is an inaccurate reflection of (a) what the Treasurer has said and (b) what is actually happening.

Senator CONROY—You are using them to delay the realisation of the losses.

Dr Parkinson—And in months where there is less than the amount maturing, we are using them to bring forward the losses. You cannot have it both ways.

Senator CONROY—No, the Treasurer cannot have it both ways. He cannot tell the Australian public he has ended it, when in actual fact there is an ongoing policy. Whether it is a well-managed, orderly policy, I am not disputing.

Dr Parkinson—There is no increase in the net exposure; the net exposure is falling every month. What is happening is that in some months we are bringing forward the losses or gains because there is not enough stock maturing to fit with our profile, and in others we are pushing it off a month or two because there was an excess amount of stock. And it is being done to ensure that the market is not disrupted.

Senator CONROY—I have a couple of questions that it is probably easier to take on notice.

Dr Parkinson—I am happy to do so.

Senator CONROY—If they are able to be answered I would appreciate it. Can you explain why these foreign exchange forwards were purchased? You have done some of that, so I will happily move on. How many forward contracts were entered into? What was the size of each transaction in Australian and US dollar terms? How does this compare to the size of maturing swaps? At what forward exchange rate were these contracts executed? What was the maturity of each contract? Have subsequent maturities been rolled over into new contracts and, if so, on what terms, size, exchange rate, maturity et cetera? What impact did these forward foreign exchange currency contracts have on the foreign currency exposure of the portfolio? You are going to say zero, I presume. Did they increase or simply maintain foreign

currency exposure of the policy as currency swaps matured? Are you happy to take all that on notice?

Mr Allen—We are happy to take those questions on notice, although I would draw your attention to a press release that was made in conjunction with Treasury on our activities with respect to cross-currency swaps.

Senator CONROY—I have it.

Mr Allen—As you would see there, most of the details you were seeking confirmation of are effectively outlined—

Senator CONROY—Well, there is a graph.

Mr Allen—in that graph.

Senator CONROY—But the graph does not give me the details.

Dr Parkinson—We will take it on notice.

Senator CONROY—We want the actual specific numbers, okay? Thank you.

Senator SCHACHT—It is like a rainfall chart. The drought came on the losses!

Senator CONROY—At February's estimates, Mr Allen, you indicated that realised losses over 2001-02 were in the order of \$200 million. Do you recall that conversation?

Mr Allen—I do, yes.

Senator CONROY—What are the updated, realised losses for 2001-02?

Mr Allen—I think that we have just covered that.

Senator CONROY—That was the same figure?

Mr Allen—Yes.

Mr McCray—There was a realised gain in 2001-02, Senator.

Dr Parkinson—You might recall that when Mr Allen spoke to the JCPA he provided them with a table that showed, as a rule of thumb, where outcomes would be based on a range of shocks. That indicated that for every 1c increase in the US dollar the total gain—that is realised and unrealised—improved by about \$190 million. So relative to those numbers that are in the portfolio budget statement—\$558 million—which was at an exchange rate of a bit over 53c—

Senator CONROY—Are you trying to tell me that you have only lost \$4 billion and not \$5 billion?

Dr Parkinson—No, actually. I was waiting for this to come up. Before we go any further, I have listened to more false commentary about this issue over the last three months than I would have believed possible.

Senator CONROY—I thought Dr Henry and the Treasurer had written copious—

CHAIR—Order, Senator Conroy!

Senator CONROY—Welcome back, Senator Brandis!

CHAIR—Senator Conroy, let Dr Parkinson finish!

Dr Parkinson—I said to you, when I gave—Senator Conroy, I assume that we may as well leave then.

Senator CONROY—I have actually finished—in all seriousness.

CHAIR—Order!

Senator Ian Campbell—Point of order!

CHAIR—Order! Dr Parkinson, please finish your answer.

Senator Ian Campbell—Can I raise a point of order, please, Mr Chairman?

CHAIR—Yes.

Senator Ian Campbell—The point of order is that a question was asked by Senator Conroy, Dr Parkinson was seeking to answer it and Senator Conroy turned around, packed up his books like a schoolboy just before the bell rings and is now conducting a conversation with Senator Sherry. I think the minor courtesy for Senator Conroy is to at least pay attention when the Treasury officer he has asked a question of seeks to answer it.

Senator CONROY—Could I just—

CHAIR—Order! No, I am not ruling on the point of order at the moment.

Senator CONROY—I take a point of order then: Senator Campbell actually is completely wrong in what he just said.

CHAIR—There is no point of order.

Senator CONROY—In actual fact, I never spoke to Senator Sherry.

CHAIR—Order! There is no point of order!

Senator CONROY—So the only childish behaviour going on here is from Senator Campbell.

CHAIR—Senator Conroy, I am speaking! Dr Parkinson, I have a statement: would you please finish your answer.

Dr Parkinson—Our position was put very clearly in the introductory comments when we met last time. I am not going to rehash that, but I would make the point that the fact that this policy may have generated \$1 billion or \$1¼ billion—who knows what the figure will be by 30 June this year?—no more validates the policy than the fact that it made a loss in any previous year or in any two previous years. It is a policy designed for the long term. The only point I would make about the \$5 billion is that it is entirely spurious to believe that you could have liquidated \$3 billion worth of gains and avoided \$2 billion worth of losses, which is where the \$5 billion comes from. We can debate this for as long as we like—

Senator CONROY—I am glad you acknowledge you are having a debate.

Dr Parkinson—Well, I do not think we are throwing much light on it!

Senator CONROY—I have actually finished this section. I would have thought that the Treasurer and Dr Henry have made frequent interventions into the public debate on this, and I appreciate your wanting to add to the public debate on it. Thank you.

Dr Parkinson—Thank you, Senator.

CHAIR—Dr Parkinson, do you consider that you and your officers have had sufficient opportunity to put your position on the record in relation to the matters that you have described as the ‘misrepresentations’ of what occurred at the additional estimates?

Senator SCHACHT—This is a new form!

Dr Parkinson—I do, and I thank you and the other senators for their indulgence.

Senator SCHACHT—Suit yourself, Senator Brandis; you are setting a new standard.

[2.18 p.m.]

CHAIR—I welcome to the table officers of the Department of the Treasury, and we now turn to outcome 3, Well functioning markets.

Senator SHERRY—I think we touched on this issue last time, Mr Ray. Schedule 10B of the regulations made under the Financial Service Reform Act 2001 requires superannuation funds to disclose what is known as their ongoing management charge, commonly known as the OMC, as a percentage of their product disclosure statements, commonly known as the PDS, subject to transitional provisions. Can you confirm that the OMC excludes entry fees, exit fees and contribution fees?

Mr Ray—It excludes entry and exit fees.

Senator SHERRY—And contribution fees?

Mr Ray—What do you mean by ‘contribution fees’?

Senator SHERRY—I mean commissions for the person selling a particular product.

Mr Ray—As in the entry fee?

Senator SHERRY—Yes.

Mr Ray—That is excluded. The commissions on investment are included.

Senator SHERRY—I was going to get to that. Can you provide an estimate—obviously this would vary from product to product—of the proportion of total superannuation fees and charges that would be excluded from the OMC?

Ms Vroombout—As you say, it will vary significantly from fund to fund. Some have no entry fee; some have no exit fees. It would be very difficult to give you an average of those because they do vary so widely.

Senator SHERRY—On that point—I understand that it is not easy to do it—have you carried out any consultation with industry and identified different products where clearly there are significant, as in this case, entry and exit fees? What sort of proportion would these products form of the total fee structure?

Ms Vroombout—I think the point to make on that is that, in addition to the disclosure of the ongoing management charge, schedule 10B also requires disclosure of entry and exit fees.

Senator SHERRY—I was going to get to that point. I want to deal with this issue of the incorporation of fees and charges in the ongoing management charge. I understand disclosure, and I will get to that a little later. Would Treasury agree that it is possible for a fund with higher total fees and charges to have a lower OMC than one with lower total fees and charges?

Mr Ray—That is simple arithmetic.

Senator SHERRY—But it can happen.

Mr Ray—It could happen.

Ms Vroombout—Yes, it could happen.

Mr Ray—But Ms Vroombout’s point is that it all needs to be disclosed in the PBS.

Senator SHERRY—I will get to what I see as a problem with the disclosure. I am dealing at the moment with what is in the OMC. Does Treasury believe that a consumer comparing funds on the basis of the OMC could be misled into believing that a superannuation fund's fees are lower than they actually are?

Ms Vroombout—What the disclosure requires, in addition to the OMC, is a statement that the OMC is not a complete statement of fees and charges. In that context, the consumer should be aware. They receive a warning that the OMC is not the complete answer.

Senator SHERRY—I am going to get to that. The warning that you refer to has some interesting issues in itself. If a consumer reads the OMC then they may be misled.

Ms Vroombout—If that is all they read.

Senator SHERRY—Have you done any consumer research—focus group research—on the extent to which people are going to rely just on the OMC? Have you sat down and analysed what people will do?

Mr Ray—We have not conducted focus group research but various industry organisations have conducted various forms of research.

Senator SCHACHT—Insurance and the super industry have conducted research—not independently.

Senator SHERRY—I know you are right, Mr Ray. I understand you have been consulting with a range of organisations?

Mr Ray—Including consumer organisations.

Senator SHERRY—I know; I have met with consumer organisations. How do people who are functionally illiterate read an OMC? I understand about 12 per cent of the population are functionally illiterate.

Mr Ray—It is important that people get good advice. I think someone could read it for them.

Senator SHERRY—I accept that. I think that is a good point. The functionally illiterate cannot read the OMC—for obvious reasons—and there might be another proportion of people who do not read it either, or do not understand it. They go and seek advice; it is logical to conclude that they will pay for that advice, isn't it?

Mr Ray—That is not only logical but probably desirable.

Senator SHERRY—That they pay?

Mr Ray—There is a view that it is preferable for consumers to pay for advice directly in a fee rather than through other forms.

Senator SHERRY—The issue I am getting at, though, is that if consumers in a category cannot read it then the most effective way would be for them to pay for advice.

Mr Ray—Correct.

Senator SHERRY—Ms Vroombout, you started to touch on this issue. What purpose is an OMC going to serve, given that the regulations prescribe that its disclosure should be accompanied by these words:

The ongoing management charge should not be taken as representative of the actual fee and charges and expenses that will be borne by the individual.

So what is its purpose?

Ms Vroombout—To give you a broad indicator to enable you to compare funds but not to compare for your own individual circumstances.

Senator SHERRY—But if consumers are going to the OMC—and that is the document they are most likely to look at, we would hope—

Mr Ray—Well, they look at the PDS. The OMC is disclosed in the PDS.

Senator SHERRY—I will get to the broader part of the PDS shortly. The OMC, as I understand it, is a document to provide some disclosure for comparability purposes. The theory is: you sit down as a consumer, you have a number of OMCs in front of you and you make an informed choice. That is the theory, isn't it?

Ms Vroombout—Along with a range of other information. It is not just the OMC but a range of other information.

Mr Ray—The OMC is a number.

Senator SHERRY—Yes. Do you have any idea of the number of pages there will be in the product disclosure statements?

Mr Ray—In the examples I have seen there are quite a few.

Senator SHERRY—Quite a few. As I understand, it could be 10 pages or 50 pages—it can vary.

Mr Ray—It would depend on the complexity of the suite of products in that statement.

Senator SHERRY—Will the ongoing management charge be on the front of that document?

Mr Ray—No.

Ms Vroombout—I would not expect it to be but that would be ultimately up to the particular product issuer. I would not expect it to be.

Mr Ray—The examples I have seen did not have it on the front cover.

Senator SHERRY—Thank you, Mr Ray. I think that is accurate. The theory is that millions of consumers—and I am talking here in the context of superannuation—get product disclosure statements of varying lengths: 10, 20, 50 pages or whatever. I have seen some that are actually a lot longer than 50 pages. Assuming they can read the document, they then have to identify this ongoing management charge, which does not give the total fee and charge.

Mr Ray—Correct, but, as Ms Vroombout has explained, the other fees and charges also have to be disclosed in that document.

Senator SHERRY—I am going to get to the other fees and charges and the way they are disclosed in a moment. We have an ongoing management charge but it is not a total expenses ratio, is it?

Ms Vroombout—No, it is not.

Senator SHERRY—No, because the ongoing management charge excludes a number of fees which we talked about earlier. So the consumer gets the document, whatever the length is, and then attempts to identify the ongoing management charge—and let us assume that they can identify that—in the various product documents in front of them. They then further have

to identify, in each of the product disclosure statements, the additional fees and charges, don't they?

Mr Ray—Yes.

Senator SHERRY—Let us assume the consumers have gone through this process. They have these documents in front of them; they have been able to identify the ongoing management charge. Let us assume they have that figure. They then go to a different page, or pages, in the document and identify the other fees and charges that are not in the OMC. How could a consumer work out the total expenses ratio?

Senator SCHACHT—It is impossible.

Mr Ray—The total expense ratio would depend on the individual consumer's circumstances.

Senator SHERRY—Yes, I know that. Of course it would.

Mr Ray—So it is rather difficult to have that in the document.

Senator SHERRY—That is the next level of issue that I was going to get to. Assuming that they have found the OMC, in a document of whatever length, consumers are then expected to identify the additional fees and charges—whatever they may be—and to work out what a total expense ratio is. I put it to you that that is going to be difficult for a significant number of consumers, isn't it?

Senator SCHACHT—Do you reckon everyone in Treasury could work it out? That would be a good thing to start with.

Mr Ray—I do not think that any of us would suggest that these decisions are not complex decisions for consumers. What the government has endeavoured to do is provide a degree of comparison that did not exist before these arrangements and it has endeavoured to provide a more comparable disclosure regime across financial products.

Senator SHERRY—You used the word 'endeavour'.

Mr Ray—The feedback that we have had, including from consumers, is that that endeavour has been successful.

Senator SHERRY—I do not think that is accurate, from the conversations that I have had with them.

Mr Ray—I do not think that we are saying that that makes these sorts of decisions trivial; they are difficult decisions.

Senator SHERRY—I think you are right, Mr Ray. Can I give you a couple of pretty frightening figures? I have just seen some research from the British Consumers Association on levels of financial literacy. The figure that threw me—and I have no reason to believe that Australia is any different, because levels of financial literacy and levels of functional literacy in the UK are very similar to those in Australia—is that 50 per cent of people surveyed did not know what '50 per cent' was. That is a pretty startling figure, isn't it?

Mr Ray—I have not seen the study, so I cannot comment on the methodology, but I have seen similar studies in Australia which suggest that a large number of consumers have difficulty in understanding a percentage. That is why there is a requirement that it be shown as an illustrative, dollar amount.

Senator SHERRY—But the difficulty is that it is not a total dollar amount. It is not all-encompassing in terms of the total expenses ratio. How is a consumer going to work it out? The OMC is in a dollar amount, right?

Mr Ray—Correct.

Senator SHERRY—Other fees and charges may be percentages. They are not incorporated as part of the OMC, are they?

Mr Ray—Where they can be disclosed as a dollar amount, they are required to be.

Senator SHERRY—‘Where they can be’?

Mr Ray—If they can be disclosed, then they are required to be. If they cannot be calculated as a dollar amount, we cannot require it.

Senator SHERRY—That is what I find interesting, because percentages are widely used in all financial products but particularly in superannuation, aren't they? I get an argument from many people in the superannuation industry—whether it is correct or not, I do not know—that they cannot show a percentage as a flat fee.

Ms Vroombout—It might depend, for example, on the amount being contributed. The fee might be a percentage of the amount being contributed. In an individual circumstance, you cannot for each consumer in a PDS have a dollar amount if it is based on the amount contributed.

Senator SHERRY—I think a lot of that is industry spin; I am not suggesting that you are spinning it. Let us accept that what you have put is the industry position: they cannot do it. How do people usefully compare and work out a total expenses ratio or total cost? They want to know what the lineball cost of this product is. If you have an OMC which does not include all the fees and charges, they have to find in the document the other fees and charges. That may be a percentage, which the product provider says it cannot produce as a flat fee. How do they combine all of this to compare across four or five different products and come to a conclusion to say, ‘Right, that product is more expensive than this product’? How do they do that? I put it to you that it is very difficult.

Mr Ray—It may well be not that easy for some consumers.

Senator Ian Campbell—It is a crucial issue, and it is very easy just to say, ‘We should have this or that form of disclosure.’ In Australia we have had experience with disclosure in prospectuses for securities. ASIC back in 1996 or 1997 did some research on how many people actually read prospectuses, and the number was alarmingly low. We have had the experience of the Uniform Consumer Credit Code—I think that is what it is called—where anyone who goes to change their overdraft by a couple of thousand dollars gets given a lump of paper 10 inches thick and is asked to sign a bit of paper saying they have read it. We have had various experiences with regard to this issue. We have just had the consultation around the Financial Services Reform Act and the disclosure that flows from that.

The point that you make, Senator Sherry, about what consumers can understand is a pivotal point. You need to have information in front of consumers that they can actually read and understand and that is relevant to them so that they can make well-informed decisions. Just how you achieve that is particularly difficult. We have moved a helluva long way further forward from where we were a year ago, and the government is obviously very interested in seeing that objective—getting out quality information—met. Giving someone a 50-page document about their superannuation is not going to achieve that. I do not think anyone will

read a 50-page document. If you can get them to read a couple of pages of relevant, understandable information on which they can make a decision, potentially with the guidance of a financial adviser, then you are getting close to what people really need.

Senator SHERRY—Thanks for that, Minister. I am asking questions with respect to superannuation disclosure. Superannuation—at least for employees in this country—is compulsory, subject to the parameters of the SG legislation with respect to minimum salary and that sort of thing, isn't it?

Mr Ray—It is. The fees and charges on that are quite competitive.

Senator SHERRY—It varies from product to product, doesn't it?

Mr Ray—It does, but all of the studies we have seen suggest that it is more than 97 per cent—less than one per cent—

Senator SHERRY—I agree with your comment. There are some dreadfully expensive products—or products that are much more expensive than others—in some sections of the market. It is interesting that that is in a regime where there is no deregulation or so-called choice of superannuation, isn't it?

Mr Ray—Correct.

Senator SHERRY—Isn't it true that, from the international studies that have been done—and the UK and Chile are two quite interesting examples of this—where you have a deregulated consumer market for pension products, fees and charges are higher than in Australia?

Mr Ray—I am not aware of a study which demonstrates that.

Senator SHERRY—I would say that is the case. But, if you are not aware of it, you are not aware of it.

Mr Ray—Chile has a different approach to fees and charges.

Senator SHERRY—This 97 per cent I think is a reasonably accurate figure. There is no choice in terms of superannuation funds for most people, at least in the retail market. Let us take the example of public servants, and I do not want to go to your personal circumstances—

Mr Ray—It would not take you very long.

Senator SHERRY—Public servants are in the PSS or the CSS. The theory is that you have these product documents. Public servants, along with millions of other Australians, will get these product documents in front of them and, hopefully, they will make an informed choice, won't they?

Mr Ray—We do not have any choice.

Senator SHERRY—But the theory is that, with product disclosure and deregulation, there is the so-called choice option for superannuation. As a consumer, you will have to sit down with these product documents in front of you; you will have to go through them and, hopefully, you will make an informed choice. Isn't that right?

Mr Ray—The intent of the disclosure regime is to improve the ability to make an informed choice.

Senator SHERRY—The issue of advisers has been mentioned. You have indicated that, if a person does not understand, they are likely to go to an adviser. Is that right?

Mr Ray—You might want to ask Mr Knott this; but I think people would prefer that, if they did not understand, they sought advice.

Senator SHERRY—I would certainly prefer that too. But the point I am getting at is this: at the moment, under the structure of superannuation, you do not have to go to an adviser and ask for technical financial advice, do you? In most cases, you do not.

Mr Ray—It would depend on personal circumstances—for example, whether or not you are contributing more than the SG amounts.

Senator SHERRY—Let us take the case of public servants. Public servants do not go to a financial adviser to get advice about the structure and the nature of the fees and charges on their scheme, do they?

Mr Ray—Public servants quite commonly go to financial advisers to get advice about what they should do with it.

Senator SHERRY—What they should contribute?

Mr Ray—Yes.

Senator SHERRY—They do not go and ask about fees and charges, do they?

Mr Ray—Presumably that conversation would involve—

Senator SHERRY—I hope they are advised that it is a pretty good deal—because it is, isn't it?

Mr Ray—The fees and charges on public servants are low.

Senator SHERRY—In connection with your comments that 'people should go to an adviser', the number who will do that will obviously vary. It might be 10 per cent, 20 per cent—who knows. But people will go to advisers and they will be charged for that advice, won't they?

Mr Ray—One would expect that.

Senator SHERRY—Yes.

Mr Ray—I am not sure that I said 'should'. If I did, I probably should have said that it would be desirable.

Senator SHERRY—In some form they would be charged. They will be charged either straightaway with some sort of fee or, as is happening in many cases, with an ongoing fee or commission.

Mr Ray—Correct.

Senator SHERRY—That is common practice, as I understand it.

Mr Ray—Correct. Under the changes that the FSR Act introduced, how they are going to be charged will be disclosed to them up-front.

Senator SHERRY—If they can find it in all this documentation.

Mr Ray—It is not in the PDS; it is in a different document.

Senator SHERRY—Another document?

Mr Ray—That is correct, yes.

Senator SHERRY—So millions of Australians, under the theoretical concept of choice, with deregulation of superannuation, will have to become involved in this process, won't

they? When I last looked at the number of people who will become involved in this process, it was about eight million.

Mr Ray—Just as they are involved in opening bank accounts or taking out mortgages.

Senator SHERRY—That is an interesting observation. But they are not compulsory. It is not compulsory to open a bank account?

Mr Ray—No.

Senator SHERRY—I am now referring to the superannuation guarantee contribution, which is the minimum amount required by law—and I am not going to refer here to voluntary contributions where people really do, I think, sit down and decide whether they are going to put in extra money. Do you think it is reasonable that the fees and charges, no matter how they are charged, should be debited against the superannuation guarantee contribution?

Mr Ray—I think you are asking me for an opinion.

Senator SHERRY—Let us go back a step. Can you tell me what the end result is of a one per cent fee and charge on the final accumulation of a person's superannuation fund; what is the impact, approximately? I am not going to hold you to the nearest per cent, but can you tell me approximately what the impact is?

Mr Ray—Not off the top of my head, no.

Senator SHERRY—Would it surprise you that a one per cent fee and charge reduces the final balance by at least 10 per cent?

Mr Ray—Depending on the term over which the person is a member of the fund, that sort of order of magnitude is all right. I would have to do the compounding, but yes.

Senator SHERRY—It is the compounding impact. You have put a reasonable parameter: it depends on their length of time in the system, whether they are 20 years old or 40 years old.

Mr Ray—Yes.

Senator SHERRY—But one per cent has a compounding reduction of about 10 per cent. It does vary, but that is about the average. Have you done any research that indicates whether the general population knows that that is the case?

Mr Ray—We have not in Treasury, no. We are aware of some studies on this issue, and we think it is important, as do the government. That is why they want a competitive market: to push those fees as low as possible.

Senator SHERRY—You made the point earlier that about 97 per cent of people are being charged total all-up fees and charges of one per cent or less.

Mr Ray—That is from the studies I have seen.

Senator SHERRY—The remainder, three or four per cent—whatever the percentage is—are people who are charged higher fees and charges, aren't they?

Mr Ray—Correct.

Senator SHERRY—I think that is consistent with the IFSA survey, the ASFA survey and the Bateman University of New South Wales survey.

Mr Ray—The Bateman work is not a study on fees. It is a study on costs; it is a different study. But it is probably fair to say that Dr Bateman's work is in that sort of ballpark.

Senator SHERRY—I find it interesting that we have this quite small group who are charged higher fees and charges—two to five per cent—which obviously has a much greater impact on the long-term final balance in their superannuation accounts. Aren't these people exercising choice at the moment? This is the group of people who are going out and picking a product and being charged those particular fees because they can exercise choice.

Mr Ray—I am not sure about that. The 97 per cent that I was referring to concerned only SG contributions.

Senator SHERRY—But I would suggest to you that this group is made up of people who are purchasing individual products—often the self-employed, for example.

Mr Ray—I think it is likely—I stand to be corrected—that the higher charges are in retail products. But those products are not strictly comparable with some of the large employer schemes.

Senator SHERRY—Do you think it is desirable, from the point of view of either an individual or the country's retirement incomes system, that the policy parameters, whatever they are, ensure that fees on superannuation do not go up?

Mr Ray—I think the government would say that, from a retirement incomes policy point of view, it is desirable to have as competitive fees as possible. Whether that means they go up or not depends on whether the costs of running the fund go up.

Senator SHERRY—So, in respect of superannuation, the Financial Services Reform Act is part of this competitive model that is being developed.

Mr Ray—It is.

Senator SHERRY—My comments here are confined to superannuation. With this competitive model that is being developed, can you give an undertaking that fees and charges will not go up?

Mr Ray—The Financial Services Reform Act improves the disclosure of fees and charges. It is not about determining the level.

Senator SHERRY—Link that in with the deregulation of superannuation products, this so-called choice—because this is part of the framework that is seen as critical for that, isn't it?

Mr Ray—Indeed. This framework was designed with a choice environment in mind.

Senator SHERRY—So we get this framework in place. Let us assume that this so-called choice passes the parliament. Can you give an undertaking that fees and charges will not go up—that they will go down as a result of the alleged competitive pressure?

Mr Ray—Other things being equal, the more competitive the market, the lower you would expect the fees to be.

Senator SHERRY—So you believe that fees and charges will go down?

Mr Ray—On a particular product, no, I could not comment either way.

Senator SHERRY—There is the overseas experience. With the United Kingdom, which is the most directly comparable, isn't it true that the fees went up?

Mr Ray—I do not have personal knowledge of that, but what we do know is that the fees in Australia have been coming down over time.

Senator SHERRY—I agree with you. It is in a controlled retail structure, isn't it?

Mr Ray—What is driving that partly, of course, is the base.

Senator SHERRY—I do accept that. As a percentage, the base has gone up.

Mr Ray—There are economies of scale involved.

Senator SHERRY—Exactly. Isn't it true that fees and charges generally in a larger superannuation fund are lower than fees and charges in a smaller fund? This is as a general rule.

Mr Ray—I think there are economies of scale, but particularly in terms of the investment management component of the fees and charges. In terms of the administration of the funds, the processing of contributions and all of those sorts of things, it is pretty linear.

Senator SHERRY—There is a fixed administrative charge; I agree with you. But also, importantly, there is a distribution cost, isn't there?

Mr Ray—In a retail fund?

Senator SHERRY—Yes.

Mr Ray—Yes.

Senator Ian Campbell—Perhaps I could interrupt for a moment just to put in one small note of caution. It may be the case that you get economies of scale with larger funds. But I would not want small funds to be given a bad name because sometimes the investment performance of smaller funds—which ultimately will have a much larger effect on the outcome for the individual investor—will potentially have a much larger impact on the net wealth, the wellbeing, the living standards of the individual investor or superannuant than an argument over a percentage of the fees. Again, it would be a gross generalisation to say that small funds outperform large funds, but there have been some large funds that have performed very averagely or below averagely in Australia and there have been some smaller funds that have performed very well. Over the previous five years, some superannuants and other investors would have been a lot better off having their money in some of the smaller funds than in some of the bigger funds. All I am saying is: let us balance the argument not just about fee levels but also about investment performance.

Senator SHERRY—I had not got to the investment performance issue. Mr Ray, are you aware of any investment return surveys that indicate how DIY funds do, for example, versus what would be classified as small superannuation funds versus large superannuation funds? This is in terms of investment return.

Mr Ray—I am aware of things like Morningstar and Assert and those sorts of surveys.

Senator SHERRY—Isn't it generally true that, for the majority of funds, there is not a significant difference in long-term averages?

Mr Ray—I think the research shows that most funds perform pretty close to a benchmark over time. But you need to be careful with that research, because it tends to suffer from various statistical problems—survivor biased and those sorts of things.

Senator SHERRY—I accept that. In the last survey I saw, I think that 80 per cent of superannuation funds have now what is called 'investment choice'? There is a category, a menu, where you can pick options within the fund for the placing of your funds.

Mr Ray—It is certainly correct that that is quite common.

Senator SHERRY—The latest statistic I have seen is 80 per cent. If a person is concerned about investment return, if that is an issue for them and they are financially literate enough to go around and search out the fund that is better, at the moment in 80 per cent of funds—certainly it does not yet appear to be an option with 20 per cent—they can pick the investment category they want their money to be placed in, if that is their wish.

Mr Ray—I think that follows from what you have said.

Senator SHERRY—Is there any mechanism that will require the reporting of total fees and charges to a regulator that can be accessed for statistical purposes to see what fees and charges are being charged?

Ms Vroombout—In the member information provided annually, members will get information about fees and charges. That information is also, along with fund information, accessible to the regulator.

Senator SHERRY—But we have established that, at least for some people, it is a little difficult to get to this total fee and charge information. Whether ASIC, APRA or whoever, is there an organisation that will gather up this data and say, ‘Well, this is what the total fee and charge is, and this is what is actually happening in reality’?

Mr Ray—There is not a regulator that is going to do that. But, as you know, the retail sector and the wholesale sector are quite competitive, and the lead tables of these sorts of things are published all the time.

Senator SHERRY—Yes, I understand that. But isn’t it better to get a comprehensive document, report or survey from a government authority rather than to have to rely on surveys—I think there is a bit of self-interest in some of those I have seen—from an industry organisation? Isn’t part of effective regulation and reporting being able to access comprehensive comparable and unbiased statistical data?

Mr Ray—The material that I was referring to was not that which is prepared by industry organisations. I guess I am a little hesitant about the question because you would need to undertake a cost benefit analysis.

Senator SHERRY—You may or may not. But the fact is that at the moment you cannot get it, can you?

Mr Ray—No; it is not costless.

Senator SHERRY—At the moment you cannot get that sort of data, can you?

Mr Ray—I am saying that at the moment, in the marketplace, there are sources of the sort of data you are talking about.

Senator SHERRY—But is there any government organisation—whether APRA, ASIC or whomever—that at the present time gathers and publishes this data on fees and charges?

Mr Ray—No.

Senator SHERRY—APRA publish *Super Trends*, which is a pretty good document—it has lots of investment, moneys going in, number of funds, and all that sort of thing—but there is no published data in that document, for example, on fees and charges, is there?

Mr Ray—The Superannuation Working Group looked at this particular set of issues, and some recommendations along the sorts of lines that you are proposing were floated in the draft recommendations.

Senator SHERRY—That has not carried through to finality yet; there has been no government announcement about it.

Mr Ray—The government is still considering that report. That may or may not be a live issue.

Senator SHERRY—I hope it is a live issue.

Mr Ray—They were draft recommendations, that were recommending—

Senator SHERRY—I am not expecting any comment on draft recommendations or what the government may or may not do; we will see in due course what they do. I will conclude and wish you all the best in this brave new world we have just been discussing.

Mr Ray—Thank you.

Senator SCHACHT—On and off over the last two or three years of estimates, I have probably been making the mistake of asking the wrong agency my questions about consumer advice on superannuation reporting. I have been doggedly pursuing APRA and ASIC, and each of them kept saying it was the other I should be asking. Then today somebody gave me the advice that actually you, Mr Ray, are the person I should be directing my questions to. I wish they had told me this two years ago!

Much of my questions is related directly to what Senator Sherry said, but I am going to take it on from more of a consumer perspective based on my own experience. I think my experience shows a deficiency in consumer advice which I think is very simple to fix. I do not want to say they would scream like stuck pigs, but I am sure the industry will say that, if some of the changes I am going to suggest to you were actually made, it would be the end of civilisation as they know it—even though I think the changes are very modest.

Without naming the fund, I had a rollover fund from a previous occupation in the mid-1980s. I put it into a well-known super fund—because otherwise you would have taxed me 30 per cent, which is fair enough—and every year I would get the annual report. A two-page letter would come from the super fund saying, ‘Your amount of money has gone up by \$X, these are the percentage figures for our management fees et cetera.’ I do not think I am one of the unfortunate 12 per cent of the population who is functionally illiterate—I think I have reasonable reading comprehension—but, by God, it was hard to work out.

The management fee was split into two levels: one fee set at up to one per cent for one pool of management; the other had 0.9 per cent added on. When I read it, it was not clear whether that was a percentage fee taken on the increase for the year of the actual fund or whether it was being taken off the total amount of the fund. So I rang the fund on one of those goddamn 1800 numbers. I am sorry! Oh, the acting chair is not here, so he cannot call me out of order for using that word. It was a bizarre conversation. All I said is, ‘I want you to tell me, in dollars and cents, for the year just ended how much those percentage figures meant.’ I had endless conversations. In the end I ignored the 1800 number. I used the fact that I was a senator in order to get through the Kremlin wall to talk to the managing director. I said, ‘Why can’t you tell me, in simple dollars and cents, how much you have taken out?’ The excuse was given that because there was a rolling increment of investment every day—money coming in and out—they could not tell me. I said, ‘Are you trying to say that you don’t know how much you have got coming in every day to pay the wages and salaries of all your staff? Surely you must have a better accountancy system. Surely it is not impossible to write a software package in your computer?’ They kept saying it was.

For three years I tried. On the fourth year—after several battering phone calls—they finally, after six weeks, sent me a letter to tell me in dollars and cents how much they had taken out. I said, ‘I want that every year!’ They said, ‘No, we can’t do it.’ I asked, ‘Aren’t you required to do it?’ They said, ‘No, the law doesn’t require it. What we are doing is what the law requires.’ I think this comes back to what Senator Sherry said; that is, if 50 per cent of people do not know what 50 per cent means, they would certainly know if 50 per cent meant \$637.58 one year and \$857 the next year. Most people, even functional illiterates, could work out what it is in dollars and cents. It may be easier to ring a couple of other super firms—which is what I did because I got a tip off that another firm charged a dollar a week minimum fee plus a small percentage. I found out that I saved—and this is not a big fund—over \$300 a year. But if you compound that out, as Senator Sherry pointed out, over a 30-year life that is going to be tens of thousands of dollars in the lump sum or pension.

I tried this with ASIC and APRA, and they kept saying that I should try someone else. Are you the person who can advise the Treasurer to change the law, the regulation or the administrative decision, to tell the funds that each year—in that one page statement; not the document that Senator Sherry described in 50 pages, which most of us would not understand—

Senator SHERRY—That is the new proposal.

Senator SCHACHT—when they send their annual reports they are required to tell us, in dollars and cents, what was taken out. It is a long introduction, but I wanted to explain it to you as you have not been through all the other hearings.

Mr Ray—I guess the answer to your question is yes.

Senator SCHACHT—You can do it?

Mr Ray—No, we are the people to ask.

Senator SCHACHT—I have been trying for four years!

Senator Ian Campbell—Congratulations, you have made it!

Senator SCHACHT—Hallelujah! Thank you very much, Mr Ray.

Senator Ian Campbell—You can go now.

Senator SCHACHT—I made it on my last estimates! I am thankful for small mercies! Would it require a change of legislation, a regulation, a disallowable instrument or an administrative decision if the government chose to adopt the policy that I am outlining? Just tell me, factually, which way is it?

Mr Ray—It is a regulation and the regulations require disclosure in dollars and cents where it can be done.

Senator SCHACHT—But, from what I am told, no-one is disclosing it. They are all saying they cannot do it. Even the new fund I went to said, ‘No, we can’t do it.’ I battered that bloke around and, finally, he told me in dollars and cents. Why can’t they do it?

Mr Ray—Because it will vary depending on the balance in your account.

Senator SCHACHT—Aren’t we at an age where all these characters run computer systems? They have all got our accounts on a computer. Isn’t it possible for one information technology expert to write a software program for 350,000 people in this particular fund and of this particular description? Surely they must know at the end of the year, for their own

accountancy purposes, how much they have taken out to pay for the running of the service of the fund themselves?

Ms Vroombout—They do know the total amount, but to attribute that to each individual depending on their balance, which varies throughout the year, is a more complex process.

Senator SCHACHT—We can send a bloody rocket to the moon or to Mars and back, and you are telling me that we cannot put a software program together that will do this?

Mr Ray—No, we are saying what the industry is saying.

Senator SCHACHT—Of course they would say that, wouldn't they?

Mr Ray—The question is: who would pay for it? And it would be the members.

Senator SCHACHT—They would pay for what?

Mr Ray—For the development of the software.

Senator SHERRY—The surcharge cost a bit with regard to the development of software in the superannuation industry but that was not an impediment to the policy, was it?

Mr Ray—The government decided that the benefits outweighed the costs.

Senator SHERRY—That is right, and the industry went out and developed the software.

Mr Ray—In this case, the decision has been that the benefits do not outweigh the costs.

Senator SCHACHT—Are you trying to tell me that the costs in this case would be at a level that would be a real burden on the individual—to have one software package designed that would then last forever and a day? We are not building the Taj Mahal, the bloody Sydney Harbour Bridge or something like that; we are talking about a software package.

Senator Ian Campbell—I think it is an issue that the senator could easily take up with one of the large industry funds.

Senator SCHACHT—I have taken it up. That is what I am talking about.

Senator Ian Campbell—Go and talk to them. Get them to say why they find it would be burdensome for them to do it. As from 11 March, this government is requiring more disclosure of fees in relation to superannuation than has ever been required in Australia before. That is what has changed since last time we met: 11 March came and went and we now have this new disclosure regime. We can talk about it endlessly, but it is probably worth going along to one of the funds and having a meeting with them for an hour at the fund headquarters. I think the issues you raise are quite legitimate, quite sensible and quite sound, but I do not think we can progress things by arguing about it here—unless you think that the government, by passing another law, can push another rocket to the moon.

Senator SHERRY—Why not?

Senator SCHACHT—Questions from Senator Sherry were about consumer protection and consumer advice, which is the bottom line on this—not just for Chris Schacht but for everybody. From the information that Senator Sherry has given, it is clear that we have the distinct problem of consumers needing adequate advice because they do not understand the document and they do not understand percentages. But they do understand dollars and cents. If your fund charges you \$650 and a bloke says, 'I think that's a bit high,' and then someone puts an ad in the paper saying that they can do it for \$350, you would be a mug not to say, 'Well, I'm going to go and check out that mob and see if they're fair dinkum.' That is the competitive market. But at the moment you never see an advertisement—I cannot recollect

one—in a paper, on behalf of a super fund or an investment fund, which talks about dollars and cents. It is always these percentage figures: two per cent or one per cent and the like. It is like standing in quicksand: two per cent of what; one per cent of what? For an ordinary consumer, talking in dollars and cents is the one thing that will always work. You have cleared up one matter, Mr Ray, after four years of being in the wrong spot at the wrong time: that you are the people who would make a policy decision, you would advise the government and, if the government accepted your advice, the regulations would be amended.

Mr Ray—On the ‘two per cent of what?’: that is required under the new regulations.

Senator SCHACHT—Yes, but it is two per cent of —

Mr Ray—What.

Senator SCHACHT—And this means that, if your fund grew by eight per cent for the year, the two per cent would be of the eight per cent growth, or something like that?

Mr Ray—It depends what it is of.

Senator SCHACHT—But you are saying that it is there.

Mr Ray—It is there; it is required under these regulations.

Senator SCHACHT—That is at the beginning?

Mr Ray—No, it is in your annual statement.

Senator SCHACHT—It is in the annual letter I will get?

Mr Ray—Yes.

Ms Vroombout—It should also say what it is a percentage of.

Senator SCHACHT—That is an improvement. I want to go to the next step: the government changes the regulation for it. As for Senator Campbell’s suggestion, I have tried to have the discussion and there is always this obfuscation and gobbledegook that the computer cannot handle it. Ms Vroombout said about the daily that in aggregate they can do it but not for separate individual accounts. They can separate individual accounts to send you your report and to take the money out of yours on an annual basis, even though they might be taking out that percentage figure on a daily shifting basis. I have raised all of that with them and they have given me the same answer they have given you. I do not believe them. I do not think it is too difficult or too expensive. I have discussed this privately with Senator Watson. He is chairman of the super committee, I think—is that right?

Senator SHERRY—For life!

Senator CONROY—The distinguished chair.

Senator SCHACHT—He is the distinguished chair. He suggested I write to the committee and looking at this particular angle could be a term of reference for the committee.

Senator Ian Campbell—It is actually a term of reference, as I recall, before the Joint Standing Committee on Corporations and Securities at the moment. With the introduction of FSRA on 11 March, there has been a massive change to the disclosure environment for financial products in Australia. I would be happy if Senator Schacht wanted to read a short, easily understood summary of what we have done, because it is a huge thing. The complaint I am getting more—from financial planners right through to all of the funds—is, ‘Look, can we just bed down these changes.’ They are having to bed down a significant new disclosure

regime. We are going to keep it under review and the joint committee is going to be scrutinising its implementation.

I am not saying the regime is perfect now, although it is much better than it was before 11 March, which is not to say that it cannot be improved. I would, if you wanted me to, give you a three- or four-page briefing on what the new laws and the new regulations require. From the government's perspective, we are very keen to see—apart from anomalies and unintended bits of bad drafting and stuff that comes up—the transition period, which goes for two years, stay stable so that all of the funds and the investors can understand the new regime. Obviously, through consultations through various means—my own consultations, ASIC's consultations and the joint parliamentary committee's consultation—we will review what happens during that transition.

Senator SCHACHT—Yesterday, APRA gave an answer to a question that I put on notice in February, that they are going through a consultation at the moment, which they referred to. That was in February and I got the answer about a month ago about what consultation is. APRA is not here anymore, so I cannot ask them.

Senator Ian Campbell—Was it about disclosure statements?

Senator SCHACHT—Yes.

Ms Vroombout—Was this that they review their annual returns information?

Senator SCHACHT—Yes, and they said they had had consultation in that area. Maybe I could encourage them to have a look at that. There may be a chance to speak in the last two weeks of the Senate on this.

Senator CONROY—There will be a disallowance motion.

Senator SCHACHT—I do not think I would disallow the regulation just yet, but there will be a motion. I just want to put it on the record that I think this is very important for consumers. It is the most relevant piece of information you can give them to make a judgment and therefore some calculations.

Senator Ian Campbell—Senator Sherry, are you foreshadowing a motion of disallowance for the Reps?

Senator SHERRY—No, Senator Conroy is.

Senator CONROY—It is my portfolio area.

Senator Ian Campbell—Has notice of motion been given yet?

Senator CONROY—No.

Senator Ian Campbell—But there will be a notice to disallow the regulation?

Senator CONROY—I am seriously considering that as a possibility, but I am hoping to be able to enter into some negotiations with you. You may get a tenor of that when we have a discussion in a moment.

CHAIR—Are there any further questions on outcome 3?

Senator CONROY—Yes. I am looking at the legislation and the section to do with the product disclosure statement main requirements, and information is set out of what is required, and I am looking at your regulations in 7.9 and 7.11, about more detailed information in product disclosure statements, superannuation entity or RSA. On what basis

did you single out superannuation entities or RSAs? Were you directed to? Did you receive advice to? What was the thinking behind only choosing super or RSA?

Mr Ray—At the end of the day the government does it.

Senator CONROY—I am quite happy for you to say the government gave you a direction to that end.

Mr Ray—No, this is an issue which came up in the consultations we had on the regulations on several occasions. The overarching requirements in the act are identical whether it is a managed investment, a superannuation product or whatever.

Senator CONROY—That is why I am asking why it was that you singled out one section of the industry from the intent of the legislation, which was to cover the entire industry.

Mr Ray—Because there are some special characteristics with superannuation: (1) it is compulsory, as Senator Sherry has already mentioned; (2) there are significant tax concessions attaching to it; and (3) it has to be preserved. Therefore the decisions involved in a superannuation decision are qualitatively different from the decisions involved in purchasing a managed investment, for example. Those are the sorts of reasons.

Senator CONROY—So it is okay to provide accurate information to super product purchasers but not to—

Mr Ray—No, the requirements in the act are the same whatever the product. What the regulations do is provide more prescription of the type of information; there is no change in the accuracy or otherwise.

Senator CONROY—Dollars and percentages, as Senator Schacht has just demonstrated so ably, can be very misleading between the two outcomes. Did you receive a direction from the government to only include superannuation?

Mr Ray—The government decided only to include it.

Senator CONROY—So it was a government decision?

Mr Ray—At the end of the day, yes.

Senator Ian Campbell—We make the policy.

Senator CONROY—I just wanted Mr Ray to say that it was actually you that gave that order, Senator Campbell.

Senator Ian Campbell—After very broad consultations—

Senator CONROY—With all the vested interests.

Senator Ian Campbell—with the groups of stakeholders.

Senator CONROY—Yes, all the stakeholders.

Senator Ian Campbell—If you have any suggestions for people we should consult in relation to financial services reform whom we have not consulted with, I am happy to receive it.

Senator CONROY—No, I am interested in the outcome.

Senator Ian Campbell—No-one could possibly accuse the government of not consulting broadly on the Financial Services Reform Act during 1997 through to 2002.

Senator CONROY—You hear the bits you want to hear and you ignore the bits you do not want to hear; that is what it is about—‘look after the mates.’

CHAIR—Restrict yourself to questions please, Senator Conroy.

Senator CONROY—If you could restrict Senator Campbell to answering questions and not giving commentary, that would be helpful too.

Senator Ian Campbell—I think it is unfair to attack the consultation process, which has been widely regarded by the Australian community and I do not think anyone apart from Senator Conroy would have the audacity to attack it.

Senator CONROY—If you want to give more commentary, that is fine, but if you want to verbal me I am going to object.

CHAIR—Senator Campbell, you were saying?

Senator Ian Campbell—I was trying to say that there are literally hundreds of people across Australia in the community broadly, as well as within this government, who have dedicated thousands of hours to consultation on this. The Australian Labor Party seem to have come to the debate not at five minutes to midnight but 10 past midnight, and now want to criticise the process and have just given notice that they are potentially going to disallow the regulations which are the result of extensive consultations. It is typical Labor Party form on these issues.

CHAIR—Your next question, Senator Conroy?

Senator CONROY—I am not sure he was answering anybody’s question as he was making his comments.

CHAIR—He was answering my question to invite him to elaborate on his clarifying statement.

Senator CONROY—Then I will elaborate on my question by simply responding—

CHAIR—You can ask any relevant question you choose.

Senator CONROY—You can ask any relevant he can answer, but I can only ask a question you like? Is that how we are going to be partial in the chair?

CHAIR—No, you ask your next question.

Senator CONROY—Try not to embarrass yourself in the chair, Senator Brandis. I wanted to talk about the review of the MIA, Mr Ray. I understand that Treasury has requested advice and information from requested parties on certain issues relating to the regulation of the managed investments industry, following the release of Malcolm Turnbull’s report on the MIA. What information and advice are you seeking and from whom?

Mr Ray—I will answer in general terms. If you want more detail we can provide it. The short answer is that it is all available on our web site. The Turnbull report recommended that a number of issues be further consulted on with ASIC and industry. The parliamentary secretary instructed us to conduct those consultations on the issues that the Turnbull report sets out for that process.

Senator CONROY—Whom are you consulting with and seeking information and advice from?

Mr Ray—We have posted it on the web site.

Senator CONROY—Have you listed all the organisations?

Mr Ray—No, we have sought comment through the web site.

Senator CONROY—It is just a general invitation?

Mr Ray—We also sent the material seeking further comment on those issues to all those who made submissions to the inquiry. Anyone who had made a submission is being consulted directly and the community at large has been invited to comment through the web.

Senator CONROY—Thank you. In his report, Mr Turnbull seems to have ducked the issue of costs charged by the managed investment industry. His report states:

The ACA suggested that this Review of the MIA should consider, on the basis of independent research, the movement in MERs and fees generally for investors in the transition to the MIA regime.

It was not seen as the role of this Review to commission research into fees.

Is that your understanding of the terms of reference?

Mr Ray—My vague recollection from when I read the report is that that is what the report says.

Senator CONROY—Parliamentary Secretary? I think Mr Hockey did it before you started.

Senator Ian Campbell—He commissioned the report. As I recall from when I put the bill through parliament, the government undertook to conduct a review after the transition period.

Mr Ray—It is in the act.

Senator Ian Campbell—That was probably an amendment on the floor of the Senate, no doubt. I received the report—

Senator CONROY—I am not holding you responsible for the terms of reference.

Senator Ian Campbell—There is a lot of commentary about the impact of the new regime on fees. My feedback, although I am probably biased, is that in terms of the consumer, it generally has had a beneficial impact on fees. People in the trustees industry may disagree.

Senator CONROY—It is a pity that Mr Turnbull ducked the chance to prove your theory.

Senator Ian Campbell—I would not have been averse to Mr Turnbull looking at that. The key was to look at implementation issues and anything we can do to improve that. The process that Mr Ray has described is one that the government wants to pursue. We obviously want to look at how effective the act and the new regime have been since implementation and to see whether they can be improved, without revisiting the core issue of the single responsible entity structure. I think that that was a bipartisan commitment, from my recollection, the last time I checked, even though Senator Sherry has told me that all policies are now up for grabs.

Senator CONROY—Thanks for that.

CHAIR—Mr Ray, were you about to say something?

Mr Ray—One of the issues is that the timing of the review was determined by the Senate. It took place pretty quickly after the end of the transition period. Therefore, to get the relevant data to test the sort of hypothesis you have would be quite difficult.

Senator CONROY—I do not have a hypothesis; I was just interested in finding the result. I think, to be fair, Senator Campbell, you and I debated this on the floor of the chamber back

in 1998 so we are both familiar with the debate. One of the issues that was heavily canvassed in that debate was the question of what would happen to fees. I was certainly surprised that fees were not specifically included. You have made the point that, in your view, from what you were told anecdotally, there is a success story. I am offering you an opportunity to prove that success by asking Treasury to include the issue of costs and their movements in MERs in the review that they are conducting right now.

Senator Ian Campbell—I am happy to look at evidence. There are a couple of issues, to be practical, that you need to consider. One is that there were definitely transition costs from any funds, so it is hard to make assessments. I know IFSA claimed—

Senator CONROY—Industry claimed it!

Senator Ian Campbell—IFSA, who were very supportive, as we all know, of the reform, were claiming within months that fees had come down. I do not accept those without challenge. It is nice to see. I hope the people got the benefit of it, but the government never claimed that that was one of the core drivers of the policy. The core driver was to ensure that the responsibility was sheeted home to one entity as a consumer protection measure as much as anything else. So if we get reductions in fees then that will be a bonus. The government is happy to get—

Senator CONROY—As I said, here is the opportunity to prove the anecdotal evidence. You can, here on transcript in front of everybody, ask Mr Ray to incorporate a review.

Senator Ian Campbell—And I could say, ‘I told you so’ if I am right and ‘Sorry’ if I am wrong.

Senator CONROY—Please. And you will be able to say you told the trustee companies so. But here is your chance to put it to bed. Trustee companies have maintained this for years. You would argue—and I think you did at the time—that there is a bit a vested interest, and I think that is a fair call. Equally, IFSA had a bit of a vested interest, which I think is a fair call. But here is your chance to put it to bed. Invite Mr Ray to include fees and charges, MERs, in the review he is conducting at the moment.

Senator Ian Campbell—He is not doing a review. What Treasury are doing for me is consulting on the Turnbull report so we can bring forward recommendations for any further reform of the law if required.

Senator CONROY—But as I have said, the Turnbull report did not look into this area. You have the opportunity to—

Senator Ian Campbell—Look, I am happy to seek advice on whether the Treasury, on balance, thinks there have been reductions on fees. It is quite a legitimate question to ask, quite legitimate.

Senator CONROY—I think it is.

Mr Ray—One of the reasons that Mr Turnbull might have decided not to pursue that was what I alluded to earlier. The Managed Investments Act commenced on 1 July 1998 with a two-year transition. The review was required to be taken and completed within six months of the third anniversary. And, as I think the data in the report show, what happened through the transition period is that more and more institutions entered the new regime and most of them came in in the last six to 12 months. That would mean that you only have one data point for a lot of those funds.

Senator CONROY—If we did it now—it is six or eight months since Mr Turnbull started looking at it—we might have another data point by then.

Mr Ray—By the middle of this year, for all the funds, we would have two data points.

Senator CONROY—The next time we will see you, in this forum, is probably estimates, but I think you are going to end up in front of the corporations and financial services committee on this very matter because we are holding a review.

Senator Ian Campbell—A review of the review of the review.

Senator CONROY—Unfortunately, we probably do not view hiring the Liberal Party's federal treasurer as someone to go around and have a chat to the big end of town about what the government has done—

CHAIR—Senator, you are casting aspersions on an individual and that is quite disorderly.

Senator Ian Campbell—It is not actually, because we did not hire the federal treasurer of the Liberal Party to do it.

Senator CONROY—I reckon you could find him a seat in Queensland.

Senator Ian Campbell—We did not hire the federal treasurer.

CHAIR—Senator Campbell makes that point; Senator Conroy, would you move to your next question please.

Senator CONROY—Thanks for giving me running commentary on what I am allowed to ask, again, Senator Brandis.

CHAIR—No, I am inviting you to move to your next question.

Senator CONROY—I will happily do it.

Senator Ian Campbell—I am sure Mr Hockey could have asked Ron Walker to do it, but I do not think he would have attempted it.

Senator CONROY—Yes, Ron was probably busy raking money off the state government.

CHAIR—Senator Conroy, move to your next question please.

Senator SHERRY—I did not realise it was Malcolm Turnbull.

Senator CONROY—The Malcolm Turnbull. Mr FAI, himself. He might have actually had to review his own profits. How much was Mr Turnbull paid? I think it was actually a minimal amount.

Senator Ian Campbell—You would be very surprised.

Mr Ray—It was gratis.

Senator CONROY—Yes, I think it was either minimal or free, so it was actually an act of generosity—perhaps in penitence to all those poor HIH shareholders that have lost their money.

CHAIR—Move to your next question, Senator Conroy.

Senator SHERRY—I thought Watto would be a good person.

Senator CONROY—I will do some of those issues when you appear before the corporations and financial services committee. Hopefully we will get some evidence on this as well, but if you do have any evidence that would be helpful to the committee—if there is anything you can accumulate between now and when you appear before the committee—that

would be helpful. I move to the HIH claim support scheme; the name Turnbull comes to mind yet again. Can you imagine putting Malcolm Turnbull in charge of looking at fees? There are some ironies in this world.

CHAIR—I indicate that I propose to take a short afternoon tea adjournment at 3.45.

Senator CONROY—I understand that the HIH Claims Support Scheme Ltd is a public company which, under a contract with the Commonwealth, administers the support scheme for policyholders who suffered a loss when HIH collapsed. Is that correct?

Mr French—Yes.

Senator CONROY—More precisely, what services is HIH Claims Support Scheme Ltd contracted to provide?

Mr French—The Commonwealth has a contract with HCSL to assess eligibility for policyholders who make applications to the scheme.

Senator CONROY—What payments have been made to the services provider under the contract to the Commonwealth?

Mr French—I think they are, to date, in the order of \$11 million.

Senator CONROY—On what basis is the payment to HIH CSS made—on a per claim basis or on a lump sum basis?

Mr French—HCSL provides a budget to the Commonwealth annually. That is assessed by the Treasury, and funds are paid to HCSL on a monthly basis.

Senator CONROY—I would like to understand how the scheme operates. Is it correct that if an HIH policyholder has the relevant claim, they apply to HIH CSS to assess their eligibility for assistance? Is that right?

Mr French—That is correct.

Senator CONROY—Can someone other than a policyholder make a claim?

Mr French—No.

Senator CONROY—What about a beneficiary under a policy?

Mr French—No.

Senator CONROY—So only a policyholder—

Mr French—As I understand it, if a policyholder has died a third party beneficiary may make a claim.

Senator CONROY—If the only service provided is to assess eligibility, who manages the claims and makes payments to the policyholders? Is that separate?

Mr French—That is correct.

Senator CONROY—You do those as well?

Mr French—No. There is a series of agreements that HCSL has with claims managers who manage the claims on behalf of HIH, so they are the people who are assessing the claims themselves.

Senator CONROY—I am trying to make sure I have got the legal structure right. Does the person making the claim then assign all their rights under the insurance policy to HIH CSS who then manages and settles eligible claims?

Mr French—Could you repeat that?

Senator CONROY—It is complex so I am happy to repeat it and try to speak more clearly for you. Does the person making the claim then assign all their rights under the insurance policy to HIH CSS who then manages and settles eligible claims, or is there another step?

Mr French—That is correct. If they have a valid claim it is paid by the scheme. They then assign their rights in the liquidation to the scheme. Ultimately the Commonwealth would be the beneficiary of any recoveries in the final liquidation.

Senator CONROY—Down the track. If a beneficiary under a policy can make a claim, how then does a beneficiary assign the policyholder's rights under the insurance policy?

Mr French—I'm sorry, Senator—

Senator CONROY—It is all right. I keep looking down as I am reading. I am sure I am mumbling into my beard. If a beneficiary under a policy can make a claim, as we agreed earlier, how then does a beneficiary assign the policyholder's rights under the insurance policy?

Mr French—I am not sure I can answer that question; perhaps I could take that one on notice.

CHAIR—Perhaps that is because the question does not make sense. Isn't that right, Senator Conroy?

Senator CONROY—Would you be able to help me—

CHAIR—Would you like me to read your questions out for you?

Senator CONROY—No. I think it does make sense; I am just pondering how you think it does not. We are talking about a beneficiary. How does a beneficiary assign the policyholder's rights under the policy? In this case, they are dead.

Ms Welch—Beneficiaries under an HIH policy cannot make a claim; it is only the policyholder that can make a claim unless the policyholder has died, for instance, or a company has been deregistered. This is the same as normal claims under normal insurance policies in general law. If a person gets in under those circumstances a special assignment of rights is drafted and that is what is used.

Senator CONROY—And that would solve my problem. Does that make more sense, Senator Brandis?

Ms Welch—It depends on the individual circumstances; it is drafted on a case by case basis.

Senator CONROY—Coming back to the case of a policyholder, if one of the insurance companies such as Alliance is chosen to assess the claim, do they then finalise the insurance claim and authorise payment on valid claims or is that processed through HIH CSS?

Ms Welch—The claims managers are the ones that finalise the claims and make the payments to the authorised beneficiaries

Mr French—And they then seek the funds from HCSL.

Ms Welch—It is a part of the agreement that they have—to provide that service.

Senator CONROY—Can you expand on the function of the participating insurance companies? Who are they and what is their job? I think you have probably covered a bit of that already, and I suspect from my notes that Alliance is involved, but who else is involved?

Ms Welch—There is QBE, Royal & SunAlliance and Insurance Australia Group. Do you want to know the particular kinds of claims that they deal with?

Senator CONROY—If it is a long list I am happy to take on notice.

Ms Welch—It is not a long list.

Mr French—QBE essentially handle liability claims; Alliance handle claims which relate to the short tail business—the home and contents types of policies—and RSA handle salary continuance claims.

Ms Welch—The Insurance Australia Group handle claims where there is a conflict of interest for the other claims managers.

Senator CONROY—When Minister Hockey announced this scheme, he said

The HIH assistance scheme will offer to claimants 100 cents in the dollar for certain claims, and will offer 90 cents in the dollar for other claims.

I am presuming that he used the word ‘certain’ in this context to mean claims that are certain.

Mr French—No.

Senator CONROY—I ask you then to give me an interpretation of what the minister mean when he said the word ‘certain’, because it obviously has two different meanings.

Mr Ray—It meant ‘particular’.

Senator CONROY—In the notes for the applicants form that the HIH CSS give out it says that the scheme will pay either 100 or 90 per cent of the amount which the insurer would have been obliged to pay. Is there a difference between that statement and Minister Hockey’s statement?

Mr French—The numbers mean that the scheme pays 100c in the dollar for personal injury claims and that 90 per cent is paid for other claims.

Senator CONROY—After liability has been established by a court, can HIH CSS delay, frustrate or negotiate with the injured party under the contract for an amount less than 100c or 90c—as relevant—in the dollar? Are you in the haggling business, like insurance companies sometimes are?

Ms Welch—They have an obligation to provide services in the management of claims as per insurance industry practice and as per HIH policy. They do this on behalf of the liquidator.

Senator CONROY—So their job is to haggle then?

Ms Welch—Their job is to provide the same service as an insurance company would.

Senator CONROY—That bad!

Ms Welch—Exactly.

Senator CONROY—Do different administrative arrangements apply between eligible claims supported by a court judgment and those not subject to a court process or yet to go to a hearing? If not, why not?

Ms Welch—Can you clarify what you mean ‘administrative arrangements’? Are you talking about the management of the claim or the administration of the payments? Do you have a specific thing in mind there?

Senator CONROY—I have an individual case in mind but I am trying not to get into the details of the individual case. I am talking about the management of the claim.

Ms Welch—The management of the claim is as per insurance industry practice. If insurance industry practice is that it will be managed in the same way, or differently, then that is the way that they manage these claims.

Senator CONROY—How long do you anticipate it should be, on average, for a claim to be submitted, assessed as eligible and a payment made to the claimant?

Ms Welch—There is no time frame.

Senator CONROY—Please do not say ‘as per normal industry practice’.

Ms Welch—There are short tail claims and there are long tail claims; as you are probably aware, some of these claims can take many years before they are settled. The answer really is ‘as per insurance industry practice’ except that in this we have an extra process. That process is to assess eligibility first before it goes to claims management.

Senator CONROY—Have you attempted to measure this to see how efficient the arrangements are? Are you keeping any sorts of file notes—‘this has taken five years; this has taken six months, this has taken three months’? Are you looking at any sort of benchmark?

Ms Welch—As far as the claims management side of things is concerned?

Senator CONROY—Yes.

Ms Welch—Claims management is conducted on behalf of the liquidator in the tripartite agreements between HIH Claims Support Ltd and the claims manager and the liquidator. That is a service provided on the liquidator’s behalf.

Proceedings suspended from 3.48 p.m. to 4.01 p.m.

Senator CONROY—Are there any procedures under the contract for assessing the performance and efficiency of the arrangements made with HIH CSS in assessing whether the commitments made by the government to assist HIH policyholders are being met?

Mr French—Yes.

Senator CONROY—Would you please let us know?

Mr French—There are quite extensive audit rights for the Commonwealth under the agreement.

Senator CONROY—Is it possible to obtain a copy of the contract between the Commonwealth and HIH CSS? I ask because they are essentially doing a Commonwealth program but they cannot be here.

Mr French—That is something I would like to take on notice.

Senator CONROY—If you could. In reference to the previous question, if you are not able to give us the contract—and I would hope that you could—is it possible to get a summary of those procedures of assessing the performance?

Mr French—Yes.

Senator CONROY—What points of contact does a third party to an insurance policy have in these arrangements? I am thinking of someone who was injured due to the negligence of a person who had negligence insurance for that type of event under a policy with HIH. Who should they ring?

Ms Welch—Who should a third party ring?

Senator CONROY—Yes.

Ms Welch—The HIH support scheme was set up to assist HIH policyholders suffering hardship. The purpose of the scheme is to provide that assistance to those eligible policyholders, and the claims managers act on behalf of the policyholder. As with any other insurance industry matter such as this, the third party's rights are the same as a third party's rights in any other insurance industry matter. What happens in these situations is that the third party's best way of getting information is to contact the policyholder's lawyer. But you must understand that the scheme is there to assist policyholders. Let me make the point that in order for the liquidator to protect its reinsurance recoveries, and for us to be able to prove a debt, the scheme must maintain the same practice that would happen within the insurance industry.

Senator CONROY—You keep frightening me when you say that.

Ms Welch—That is the way the scheme has been set up.

Senator CONROY—I am thinking of somebody who is a victim of negligence by an HIH policyholder. Should they contact HIH CSS?

Ms Welch—The scheme has not been set up to assist anyone other than HIH policyholders.

Senator CONROY—What about a victim of the policyholder?

Ms Welch—Someone who is a third party has a right to make a claim against a policyholder. The way that they would get information would be to talk to the policyholder or the policyholder's legal representative.

Senator CONROY—If that third party is suing someone who has been assessed as eligible for assistance, who would they contact in relation to serving court documents?

Ms Welch—The policyholder's legal representative.

Senator CONROY—Would it be appropriate for HIH CSS to give legal advice to a person assessed as eligible for assistance?

Ms Welch—HIH Claims Support Ltd has been set up to provide an eligibility assessment service, call centre et cetera. Legal representation is provided on instruction from the claims managers, not on instruction from HIH Claims Support Ltd.

Senator CONROY—I guess they are getting close to providing the traditional level of service from the insurance industry, from the sound of it. If I can refer to the press release from Minister Coonan on 14 March 2002, it states that over \$42 million in assistance has been paid out to HIH policyholders since the scheme commenced in June 2001. That is only a small proportion of the \$640 million appropriated for the purpose?

Ms Welch—That is right.

Senator CONROY—Are claims slow getting in? Is that what is causing the slowness, or is it just the transition?

Mr French—Since the last budget—

Senator CONROY—I know it has been reprofiled.

Mr French—we have arranged for an actuarial review of the liability that the Commonwealth has taken on. We also took advice on the profile of—

Senator CONROY—Yes, I understand it has been reprofiled a little bit further out.

Mr French—Correct; and because there are a lot of long tail claims here, they could run out for a long period of time.

Senator CONROY—So it has not surprised you that it is only 42?

Mr French—I think the figure originally assumed for the first year was cash payments of around \$200 million. That figure has been revised to about \$90 million.

Senator CONROY—Do you think you will meet the \$90 million in payouts?

Mr French—To date \$71 million has been paid.

Senator CONROY—So it has jumped up. It has almost doubled since that press release?

Mr French—Yes.

Ms Welch—That figure includes management expenses and that sort of thing as well, so that \$90-odd million would include the management expenses for the year.

Senator CONROY—I appreciate that you say you have the actuarial report now. Do you have any estimate of how long it will be before all policyholders have been assisted?

Mr French—It might stretch out for a very long period of time because of the nature of the business.

Senator CONROY—I appreciate that it is a long tail and that it is very uncertain.

Mr French—It could run for 10 years or more.

Senator CONROY—Is the estimate still that \$640 million of liabilities have been assumed?

Mr French—No, the estimate is \$598 million in total.

Senator CONROY—That is based on the actuarial calculation?

Mr French—Yes.

Senator CONROY—I understand that the HIH claims support scheme was changed recently in relation to body corporates making claims. What are those changes and why were they made?

Mr French—We do not believe there has been a change, but Ms Welch might like to respond.

Ms Welch—What occurred was that when the scheme eligibility guidelines were initially put together, the particular circumstances of individual lot owners in residential and commercial owners corporations were not taken into account. In order to give them equal access to the scheme as individuals who meet certain criteria and as small businesses, the government set about developing eligibility criteria to allow these lot owners into the scheme. That criterion has now been finalised, forms have been designed and they have all been sent out to lot owners.

Senator CONROY—Do you know how many claims from body corporates were affected by this, shall I say, finalisation?

Ms Welch—What do you mean by ‘affected by the finalisation’?

Senator CONROY—Presumably they were going through a process previously that has varied a little bit.

Ms Welch—The process never varied.

Senator CONROY—The form changed, then.

Ms Welch—Owners corporations or bodies corporate—whatever you would like to call them—have never been eligible for assistance as a group. As I explained before, when the government realised that the eligibility criteria did not allow for lot owners to have equal access, they developed guidelines for lot owners. Prior to that, owners corporations had applied to the scheme, but it has never been government policy that they were eligible under the scheme.

Mr French—In relation to your specific question as to the number, I do not know that we would have that figure. We could take that on notice if you like.

Senator CONROY—Body corporates were not eligible?

Ms Welch—No.

Senator CONROY—But now the individuals within body corporates can apply?

Ms Welch—They can apply to the scheme.

Senator CONROY—They can now.

Ms Welch—Yes. That does not mean that all lot owners are eligible, but they are eligible in the same way that individual small businesses or not for profit organisations are.

Senator CONROY—Do you know roughly how many? Were you getting hundreds or 1,000? Do you have a ballpark figure?

Mr French—I think I mentioned before that we would take that on notice.

Senator CONROY—I also understand that, when individuals make a claim, their eligibility is affected by whether the body corporate has acted as a prudent insured.

Ms Welch—Prudent uninsured.

Senator CONROY—What does that term mean?

Ms Welch—A lot owner can apply to have their eligibility assessed and be told whether or not they are eligible, but the owners corporation must, as you say, act as a prudent uninsured. That means that they should take full care to ensure that the claim is settled in a reasonable manner—that, if it is an ambit claim, it is defended and they act prudently. In other words, if the claim is worth \$20,000 and the owners corporation decides to pay \$1 million then they have not acted prudently.

Senator CONROY—I understand that Treasury will be providing secretariat support to the review of the Trade Practices Act. How many Treasury officers will be in that secretariat?

Mr Ray—Nine in total.

Senator CONROY—Can you explain the process for determining the terms of reference? Did Treasury undertake various consultations to determine the terms of reference and, if so, with whom? Or was it just given them by the government?

Mr Ray—The government determined the terms of reference.

Senator CONROY—The government just handed them down. Four weeks have been allowed for making submissions. That is quite a short period. What was the thinking behind the four weeks?

Mr Ray—That is a decision for the review committee.

Senator CONROY—Sorry.

Senator Ian Campbell—Anyway, I support their decision. As I think I said publicly in the lead-up to the announcement of the make-up of the review committee, the fact that that committee was going to be convened and would be making these considerations was well and truly known.

Senator CONROY—The terms of reference were not well and truly known.

Senator Ian Campbell—The broad terms of reference were announced prior to the last election, and they have not changed in much detail.

Senator CONROY—Do you think people should have gone ahead on an announcement back in October, hoping that they did not change, and done a whole heap of work to then find they may have changed. Do you think people held off until they saw the final terms?

Senator Ian Campbell—We have not had complaints at all about the four weeks. If there are any, please refer them to me. Just about anyone who has had an interest in this area has made contact with me, as you would imagine, over the past few months. My assessment is that all of those people are very well prepared for the review, and I would be surprised if any asked for an extension of the time to put in their submissions. But if anyone has a complaint, please let me know.

Senator CONROY—You have given a commitment that if anyone needs that extension they can have it.

Senator Ian Campbell—No, I have not. I said that if anybody has complaints about the four-week period they can come to me. We are very keen to get the review done in good time. Very good people have been appointed to the review. No-one has criticised the process yet but, if they want to criticise the process, I ask them to please complain to me. I am happy to accept criticism and deal with it.

Senator CONROY—Maybe I misheard you but I thought you indicated that you would consider an extension if somebody approached you. I may have misheard you—

Senator Ian Campbell—Yes, you did. The committee is running the process and I have total faith in the committee.

Senator CONROY—So you think that it allows sufficient time for people to pull together their submissions?

Senator Ian Campbell—Yes, I do. The point I am making is that most people have been working on this since October or November last year. I have spoken to people at the rate of two or three people a week in the last six months. They are the sort of people you would expect to have a strong interest in this review and they have all welcomed the terms of reference and the make-up of the committee.

Senator CONROY—So would late submissions be accepted?

Senator Ian Campbell—The committee are setting down the process and I have faith in that process.

Senator CONROY—I will take that as a no. What will be the process after submissions have been submitted?

Mr Ray—Again, that really is a matter for the committee to determine.

Senator CONROY—Is the secretariat here?

Mr Ray—No.

Senator CONROY—No-one from the secretariat is here?

Mr Ray—No.

Senator CONROY—Do I need to call them separately? Are they part of your unit? Or is it just an accident that they are not here?

Senator Ian Campbell—We made a commitment to set up an independent review. You do not want it to be independent? You want Treasury to run it? What is the Labor Party's beef here? Do you want an independent review?

Senator CONROY—I am just trying to understand the structure—

Senator Ian Campbell—We have committed to an independent review and we have set up an independent committee.

Senator CONROY—But it is serviced by Treasury, so I was asking whether we are allowed to call the secretariat.

Mr Ray—The secretariat is there to serve the review committee. Decisions in terms of the process are matters for the review committee, not for the secretariat.

Senator CONROY—So can I call members of the committee, then? You cannot spend public money and say that I cannot call anybody. There must be somebody I can call.

Senator Ian Campbell—The committee is running the process.

Senator CONROY—Are you saying that I am entitled to call the committee?

Senator Ian Campbell—The government has asked the committee to conduct a review around some terms of reference and to report to the government before the end of the year.

Senator CONROY—I appreciate that. The Board of Taxation is an independent board, but I have the secretariat of the Board of Taxation appear at the table. Are you telling me that I cannot call the committee?

Mr Ray—It is not usual, Senator, as you know, for review committee secretariats to be called in the estimates process. If you have some questions on their estimates, we will endeavour to answer them.

Senator CONROY—I just want to know who can answer the question: what will the process be after submissions have been submitted? You are saying that you cannot tell me.

Senator Ian Campbell—We will give you an answer.

Mr Ray—We will take it on notice.

Senator CONROY—I would prefer to ask somebody, if I could.

Senator Ian Campbell—You just have, and we said that we will get you an answer.

Senator CONROY—No, I would prefer to ask somebody who is handling the matters. Parliamentary Secretary, am I entitled to call the secretariat or not? Or can I call the chair or whoever is heading up the inquiry?

Senator Ian Campbell—You can call who you want.

Senator CONROY—I hope you heard that, Senator Watson: we can call who we want. You will happily let them come?

ACTING CHAIR—That is your prerogative, Senator.

Senator Ian Campbell—I would take the advice of Mr Ray, which is that it would be highly unusual. If you have questions about the process, we said we will answer them. It is a very open, transparent process. They are going to receive submissions, they are going to conduct a review and they are going to report to the government by the end of the year.

Senator CONROY—We will call them to the next estimates. I now turn to the issue of corporate law harmonisation. Recently it was announced that Australian fund managers will be given streamlined access to the Hong Kong market. It was described as a mutual recognition decision. Can you expand on what is meant by that?

Mr Ray—Senator, we have been through this before.

Senator CONROY—Is it just that Australian fund managers have streamlined access to the Hong Kong market, or do Hong Kong fund managers now also have streamlined access to our market?

Mr Ray—They already did, Senator. This is a matter between the two regulators.

Senator CONROY—So you are telling me that I should ask ASIC?

Mr Ray—I think that ASIC can probably give you a quicker and more fulsome answer than I can. The short answer is that, under the mutual recognition discussions that the authorities in Hong Kong and Australia have been having since late in 2000—

Senator CONROY—Were Treasury involved in those?

Mr Ray—We were.

Senator CONROY—Who were heading them up? You or ASIC?

Mr Ray—The minister and the Hong Kong minister were heading them up.

Senator CONROY—So that would make it a Treasury responsibility, not an ASIC responsibility.

Mr Ray—This particular issue is a matter for the regulators in both countries. What happened was that ASIC applied for recognition from the Hong Kong authorities, and that has recently been granted.

Senator CONROY—Do Australian investors dealing with Hong Kong fund managers have all the same protections they would have if they were dealing with an Australian fund manager? Treasury negotiated it.

Senator Ian Campbell—Wouldn't the question be better directed at ASIC?

Senator CONROY—No, it was negotiated by Treasury.

Mr Ray—I think we are talking at cross-purposes. This is about recognising the issuers in different jurisdictions. We have had discussions before about accepting disclosure documents in different jurisdictions. This is different from that.

Senator CONROY—What was that last bit?

Mr Ray—This is different from the discussions that we had before about recognising disclosure documents in the two jurisdictions.

Senator CONROY—What I am asking is this: let us say I am an Australian ambassador; if I go through this portal—or whatever description you want to give it—do I have all the same protections as those I have when I am dealing with an Australian fund manager?

Mr Ray—As I said, this is something that is done administratively by ASIC, so maybe the quickest way is to talk to them.

Senator CONROY—You signed the agreement.

Mr Ray—No, this was a matter done between—

Senator CONROY—You said that the minister headed it up.

Mr Ray—I said that the discussions between the authorities were initiated by the two ministers. The original discussions, which involved the policy advisers in the two jurisdictions, the regulators and the exchanges in the two jurisdictions, were led on both sides by the relevant ministers. The particular matter to which you are referring is an administrative matter between the two regulators.

Senator CONROY—They are not far away, so—

Mr Ray—Yes, they are coming up.

Senator CONROY—we may hold you back and make you listen to their answers. I refer to a letter from the Australian Institute of Company Directors to Senator Campbell posted on their web site in support of the government's proposed review of insolvency law. Is there to be a review, and when will it be announced?

Senator Ian Campbell—I am currently finalising the detail of the review.

Senator CONROY—When will it be announced?

Senator Ian Campbell—When I have finalised it.

Senator CONROY—Any idea?

Senator Ian Campbell—Fairly shortly. I am keen to get on with it.

Senator CONROY—A week or two?

Senator Ian Campbell—In the next couple of months.

ACTING CHAIR—It would be done in conjunction with the Attorney-General, because he is doing some work in relation to that area, isn't he?

Senator Ian Campbell—I have spoken in broad terms about following through on basically what was a CASAC report looking at some cross-border insolvency issues and a couple of other matters. I want to finalise the detail of that before I make any further announcements, but I have spoken to him about a forward agenda for the continuation of the Corporate Law Economic Reform Program, which is designed to modernise and make more efficient our Corporations Law. That is one of the areas that I foreshadowed that I think

deserve some work, and I am going to look at the detail of that. Obviously, normal processes for the policy review process would include consultation with other ministerial colleagues.

Senator CONROY—What process are you going through in terms of determining the terms of reference?

Senator Ian Campbell—There will not be terms of reference. What I have in mind is a look at the law in the same way that the first stages of CLERP did—

Senator CONROY—So it is an in-house operation.

Senator Ian Campbell—I will be conducting it. It will be a policy process. ‘CLERP phase 2’ I am calling it.

Senator CONROY—So it is not really something for public comment at this point.

Senator Ian Campbell—No. I will be announcing the details of it in the near future.

Senator CONROY—The letter from the AICD urges the government’s review to be broadly based and the issues of employee entitlements and the clawing back of directors’ bonuses to be addressed specifically within the ambit of the review. Can you confirm, Senator Campbell, that the Prime Minister has made quite specific commitments to rank employees above secured creditors—that was made after Ansett collapsed—and to permit directors’ bonuses to be clawed back in the event of a company collapse? I believe that commitment was made when One.Tel collapsed.

Senator Ian Campbell—Yes, I can. They are both quite explicit commitments, which I am carrying forward on behalf of the government.

Senator CONROY—So they will be within this review?

Senator Ian Campbell—We are determined to carry them forward as expeditiously as possible. I do not want to rule out putting them within a broader review but I do not want to hold up the measures because of that. That is the most frank answer I can give. In other words, if further stages of CLERP would hold up the implementation of those measures, I would not incorporate them in the review.

I understand where the AICD is coming from. We are going to consult on those two measures—employee entitlements and clawback—but I do not see that they would necessarily need a broad, full-scale, CLERP-type consultation which means going to every capital city and all that sort of stuff. I am consulting with the relevant ministers about those two measures, and the Prime Minister and Treasurer are determined to proceed with them at the earliest possible time.

Senator CONROY—The answers I received from the last round of estimates indicate that meetings were held with stakeholders on 7 February 2002, 14 February and 7 March. Who do you think are the stakeholders?

Senator Ian Campbell—Is that in relation to FSRA?

Senator CONROY—I think it was in relation to a general question about insolvency.

Mr Heferen—Those dates refer to brief discussions at the law subcommittee of the Australian Institute of Company Directors—discussions that I was involved in, not the parliamentary secretary.

Senator CONROY—My last couple of questions, before I put the rest of my questions on notice, are about broker independence. There was a report on 24 May that a certain CLERP

paper would be issued in the next few weeks dealing with the independence of analysts. Are you working on a further CLERP paper?

Senator Ian Campbell—That comes under the same heading as the reforms I am alluding to.

Senator CONROY—In that case, it is a lot more interesting and more broad ranging than the narrower things I was talking about previously.

Senator Ian Campbell—There are two bits of policy that I want to develop. One is specifically in the insolvency area. There is some work that was done by CASAC pre 1997-98—

Senator CONROY—Yes, it was a while back.

Senator Ian Campbell—It was put on the backburner because of the enormous policy work that had to be done on FSRA. I think the significant work that CASAC, as I recall, did on that deserves to be addressed by the government. I am looking at how we would take that forward.

Senator CONROY—Was that on analysts or on liquidators?

Senator Ian Campbell—That was on insolvency. The next thing I think we need to have a look at—and I think David Knott, who is here with us today, would agree—is this issue of continuous disclosure and the appropriateness of the penalty regime. You may recall that Mr Knott suggested that ASIC should be given power to fine companies for failing to comply with continuous disclosure. I have said publicly that that is an issue that deserves attention.

The issue of the independence of analysts again falls into what I would broadly call disclosure and the quality of disclosure. I am working on the detail of a policy process which would give the government a coherent framework to look at those issues. Again, hopefully we will be making announcements in the very near future. I hope the Australian Labor Party and other members and senators will welcome the opportunity to participate in that.

Senator CONROY—I certainly will. I just hope we get an opportunity to participate in the early stages. Perhaps consultation would speed the way. In terms of consultation papers, are you thinking along the lines of how the CLERP documents have been; is that the sort of form?

Senator Ian Campbell—What we did with CLERP 1, 2, 3, 4, 5, 6 and 7—

Senator CONROY—There is an 8 somewhere out there.

Senator Ian Campbell—Insolvency might be 8; we will see. It is a bit like *Star Wars* or, dare I say, *Harry Potter*. Under the CLERP program, the process was to issue a discussion paper looking at the broad parameters of the policy—

Senator CONROY—So you will follow that same process?

Senator Ian Campbell—and then put that out to the whole world, including the Australian Labor Party, and then hold discussions in the capital cities and regional areas where appropriate.

Senator CONROY—Can I congratulate you on that initiative, Minister.

Senator Ian Campbell—That process is designed to ensure that, by the time you get to the parliament, you have got as close as you can get to consensus on the way to go forward.

Senator CONROY—Will that review be separate from ASIC's plan to conduct formal surveillance across the industry in the next few months?

Senator Ian Campbell—Yes.

Senator CONROY—I am happy to put on notice the rest of my questions on this section.

ACTING CHAIR—Thank you. We will now move to ASIC for 10 minutes for Senator Cook, as I understand he has a plane to catch at five o'clock.

Senator COOK—I do, unfortunately. I have tried to find other flights out of this city tonight and tomorrow night and let me tell you that, if you have not booked already, you have got no chance.

[4.33 p.m.]

Australian Securities and Investments Commission

ACTING CHAIR—I now welcome representatives from the Australian Securities and Investments Commission and in particular Mr David Knott, who has so much on his plate. We apologise for the delays. Airline scheduling out of Canberra is somewhat difficult at the present time. You have been advised of the arrangements. Senator Cook, who has a difficulty with planes, has asked that you appear for 10 minutes. After that time, we will proceed with questions for the ACCC and then recall ASIC. I regret that we will not have a longer opportunity to speak with you to hear your views because you, too, have a plane to catch and have to be out of here at 6.30. On behalf of the committee, thank you very much, Mr Knott, for what you are doing.

Mr Knott—I appreciate that, Senator. I should clarify, in terms of my own travel arrangements, that I have made some changes so that I can be here longer tonight—hopefully not all night. I do want to ensure that a range of questions can be put to me as appropriate.

ACTING CHAIR—That is further appreciated.

Senator COOK—You have had more luck than I have, Mr Knott, believe me—and tomorrow night is even worse. On a frivolous note, I am advised by Senator Conroy that you are a Carlton supporter so, on behalf of the Fremantle Dockers, congratulations on last weekend!

Mr Knott—That is very kind of you, Senator!

Senator COOK—I wrote on 1 March on behalf of a constituent concerning mass-marketed schemes. I do not think it is appropriate to go to individual constituents nor, indeed, necessarily to individual schemes, but this was a person who was being sued by a tax promoter for \$147,000 that he did not believe he owed. As a consequence of some of the attention given at that stage, there was an out-of-court settlement for what I would describe as—for want of more eloquent prose—a piddling amount.

One element of mass-marketed schemes that I think is a problem, particularly in the Kalgoorlie area where my office is situated, is where promoters have, in my view, unscrupulously promoted some of these schemes to people and taken advantage of them. Can you begin by telling us whether ASIC has been in receipt of complaints about this type of behaviour.

Mr Knott—Yes, we have. I can provide a fuller answer; I am in your hands.

Senator COOK—Can you give us an idea of what the incidence of the complaints are? I am seeking to establish whether there is a genuine concern in the community, gauged by the number of complaints that come to your agency, about this type of behaviour.

Mr Knott—Yes, I would say that there is, and the commission have been faced with the issue of how to address that problem. One obvious way is to try to respond to each and every individual complaint. The reality is that to investigate every such action is unlikely to be possible. We therefore took the view that, through Mr Johnston's area, we would put in place a program which would attempt to identify the highest risk or most culpable areas of malpractice and address that through a surveillance program to be followed up with appropriate action. I understand Mr Johnston has had some discussions with you about it and is quite willing to expand on that here this afternoon. Certainly, the issue is one of concern. The question for the commission was how best to marshal our resources to respond to it.

Senator COOK—Yes, you are quite right: Mr Johnston and I have had a discussion today as a consequence of my 1 March letter. It has been, from my point of view, a worthwhile discussion and I thank you for making your officers available.

Coming back to the issue, could you or Mr Johnston give me some sort of proportionate snapshot? You say, 'Yes, ASIC have received complaints.' Are they a large number or are they a small number? How would you describe the volume of the complaints?

Mr Johnston—The number of complaints we receive as a proportion of our overall complaints is not high, but the conduct in this area is such that, over the past 12 months, this type of activity—activities of tax-driven scheme promoters and operators—has eaten up about 30 per cent of our surveillance resources. These are complex and difficult things to investigate, largely because of the spread of the behaviour: it happens right across the country, often in remote regional areas, and we send our officers into those areas. So the proportion of resources that it takes up is very high, especially when you compare it to the overall proportion of funds that are invested in these types of schemes as a percentage of overall funds in managed investments generally. These would make up less than five per cent of amounts invested in managed investment schemes, but they take up about 30 per cent of our resources.

As the chairman said, because of the high level of resources eaten up, we have tried to tackle it on a more systemic basis. We have an activity under way right now whereby we are looking at those schemes that pay the highest levels of commission to advisers. We think that there is a nexus between the level of commission that is paid and what might be misbehaviour by some advisers. We are currently investigating quite a number of advisers and schemes in respect of their conduct in two areas: whether or not those advisers are disclosing to investors the commissions that they are receiving, which they are obliged to do under the law; and whether or not the advisers are giving appropriate advice to people who come to see them. There is a requirement under the law for an adviser to give advice that is in the interests of the client and to take into account the circumstances and needs of the client in framing that advice. We are looking at the conduct of advisers and whether they are complying with that provision within the law.

Senator COOK—I understand that you have received some complaints from the Kalgoorlie area.

Mr Johnston—Yes, we have.

Senator COOK—You have identified two types of things to watch for: the percentage of commission going to the promoter as a proportion of overall payments and the appropriateness of the advice being offered. If you were in the position of explaining to

consumers what types of things to question about these schemes, would they be those two things or are there any other typical elements that consumers should be on guard about?

Mr Johnston—Yes, there are further things and we have addressed them in a number of ways. We have published a booklet on this—a joint publication with the Financial Planning Association—with the catchy title of *Don't kiss your money goodbye*. That booklet mentions a number of things that people should ask of their adviser and take into account when selecting an adviser. How the adviser is remunerated is one; the spread of product that the adviser is able to advise people on is another. It is a particular feature of the tax driven end of the market that some promoters only offer one or two products, and that is not something that we think is appropriate. We also advise people to look at the training and education that the adviser might have and, importantly, how the adviser is remunerated by the product offerer. There are a number of other things also.

The other thing that we have done is to conduct across the country, including in regional areas, some seminars which we call 'investor forums'. Some of those have been in Western Australia. We do those from time to time and we are considering another roll-out of that type of forum, whereby we give advice to investors.

The campaign that we have under way at the moment is throwing up some cases where we think advisers have not complied with the law. I would anticipate that a number of enforcement actions will flow from this campaign with the whole range of remedies that are available to us. There are administrative law remedies—in other words, taking licences from people or perhaps banning advisers from the industry—right through to criminal prosecution, because it is a breach of the law if you do not disclose commissions properly and if you do not give advice that is in the interests of the client.

Senator COOK—One of the things that the Senate committee that conducted hearings into mass-marketed schemes considered was the tightening of the regulation for promoters. Has any consideration been given to looking at the nature of the law and reviewing whether it is adequate to meet this phenomenon as it is appearing now?

Mr Johnston—In terms of the activities of the promoters, the Financial Services Reform Act lifts the bar to a large extent. I am comfortable that the provisions of the law as they deal with the activities of promoters—in other words, having to give proper advice and having to disclose commissions—are adequate. What we have, from time to time, expressed some concern about before other committees is whether perhaps there should be a law reform in respect of the tax driven industry as such. I understand that from a policy point of view there are two things to weigh up: the consumer protection element and the fact that no doubt the government would want to encourage investment in the primary sector. I do not think that is an easy thing for government to determine. We have suggested that for us to really do something in this area would require more resources than one could ever amass—we could not respond to all of the complaints that are there. Therefore, it might be more appropriate to look at it at the front end, and there may be some law reform issues. Within ASIC we are considering whether there are some of those that we should put to government.

Senator COOK—Given that comment about the number of complaints and the resources they tie up, without being sensational about this, is it right to describe it as an epidemic of these schemes?

Mr Johnston—I would not say that there is an epidemic in the number of schemes. I would say that there is a large number of operators who operate at the riskier end of the

market. ASIC has over recent years issued a number of consumer alerts about these types of schemes. We often observe in consumer behaviour—and I think it has to be considered—that there are many consumers who go into these schemes based on the tax element and who are perhaps disregarding some of the things that they should take into account when looking at an investment. They are looking at the short-term tax deductibility. That is something which I believe the tax office is addressing.

Senator COOK—Because my word is my bond—I said 10 minutes and I intend to keep to it—I have just one final question. The tax office describe these schemes as mass-marketed schemes; I think your term is the tax driven industry. We are talking about the same thing, are we not?

Mr Johnston—Yes, we are.

Senator COOK—Have you had consultations with the tax office about interagency concerns about this problem?

Mr Johnston—Yes, we have. We have regular liaison with the tax office and we have had some specific discussion on these types of schemes. That is ongoing as we come across matters where there is common interest.

Senator COOK—Thank you very much, Mr Johnston.

ACTING CHAIR—We now call the ACCC.

[4.48 p.m.]

Australian Competition and Consumer Commission

ACTING CHAIR—I welcome representatives from the Australian Competition and Consumer Commission.

Senator ALLISON—I want to explore in some detail the report tabled in April which the ACCC made to the Senate on tobacco. Who was working on that report?

Mr Cassidy—We had a few of our staff working on that report. Mr Antich, who is on my right, was our senior officer responsible for the preparation of the report.

Senator ALLISON—But there were other staff as well?

Mr Cassidy—There were other staff as well.

Senator ALLISON—Is it possible for us to know how many and who they were?

Mr Cassidy—There were three or four.

Mr Antich—Mainly two full-time.

Senator ALLISON—The equivalent of two full-time over what period?

Mr Antich—There were at least two full-time staff and at times possibly more.

Senator ALLISON—Over what period? Presumably, 24 September until the tabling in April?

Mr Cassidy—Yes.

Senator ALLISON—Can you describe the methodology used in preparing the report? How did you go about it?

Mr Antich—To start off with, certainly, we had to look at what the motion required, and then we had to look at that in terms of the commission's role, functions and powers. That

determined, to a large degree, the sorts of areas we could and could not address in the report. Once we were aware of those issues, we were able to concentrate on the ones that we had the power, the function and the remit under the act to look at.

Mr Cassidy—I should explain that the commission spent some time early on looking at the motion we had from the Senate, basically because, as Mr Antich has indicated, we had some problems and we thought some parts of the motion actually went beyond our statutory responsibilities. So therefore the full commission spent some time considering the motion and deciding on what parts of it we would be able to respond to.

Senator ALLISON—So there was a delay while that sorting out happened?

Mr Cassidy—Not unduly, but it was not something that was done lightly, as it was a motion from the Senate. The commission felt that they did want to have a close look at it, just in a spirit of deciding how much we could do.

Senator ALLISON—And it was resolved within the commission that this was not to be referred?

Mr Cassidy—That is right. But do not get me wrong: that did not consume the first few months or anything. But it did mean that—unlike some of these, where there will be a fair bit of work done before the commission actually focuses on the key issues and the proposed directions and so forth—the commission focused on this one almost right from the outset, as I say, given that there had to be some decisions made about what aspects or elements of the motion we would be able to respond to.

Senator ALLISON—Did you call for submissions? How did you go about the inquiry itself? What did you do by way of getting the information necessary? Perhaps the officer you are conferring with should join us at the table, Mr Cassidy.

Mr Cassidy—She may before we are finished, but let us see how we go.

Mr Antich—The commission did not call for submissions. It received submissions from people, including ASH, but it did not call for submissions.

Senator ALLISON—Why was that?

Mr Cassidy—I think it was predominantly because of the terms of the motion. In a sense, the motion was asking the commission to report on our functions under the act with respect to a number of things. You would not then normally go and invite submissions from people to tell us what we should be saying to the Senate about the performance of our functions under the act. In other words, given the way the motion was tasked, it was not the sort of thing where we thought, ‘We’d better go out and see what the general public feels about this issue.’

Senator ALLISON—So did you take account of the unsolicited submissions or did you ignore them; how did you approach them? How many were there? Maybe you can take this on notice, but I wonder if we can have a list of the submissions that came your way.

Mr Antich—I guess that will depend on whether they are subject to any confidentiality, but I will take that on notice. I am just not sure; I will have to get back to you on that. On the previous question you raised, I would like to add to what the CEO has said that the terms of reference of the notice were clearly directed at the ACCC undertaking its review of investigations, amongst other things. So it was not really the focus to have submissions like an external inquiry in that way.

Senator ALLISON—So how did you use the submissions that did reach you? How did you approach them? Or did you ignore them? That was my question.

Mr Antich—No, we did not ignore them. We looked at the submissions; we looked at material that people sent us, including material that was sent from ASH. We considered the material that was in them. As you know, the motion looked at ACCC's investigations, and we looked at that information and whether it was capable of giving us further lines of inquiry. So yes, we did look at those submissions in detail.

Senator ALLISON—Did you find them useful?

Mr Antich—Yes, we did. They did inform the commission to some degree, but they did not give us adequate lines of inquiry in terms of taking the matter further. They were useful to a degree.

Senator ALLISON—So if the submissions did not give you adequate lines of inquiry, where did you then go in order to get adequacy?

Mr Antich—That is partially incumbent on the people who were providing the submissions. We did have some discussions with persons about the material we had been provided with.

Senator ALLISON—In reaching your conclusions, primarily what did you base your advice on? What did you most rely on in forming your conclusions?

Mr Cassidy—Primarily we relied on our own experience. Some of the issues that we canvassed in the report, particularly the way in which the Trade Practices Act applies in the area of tobacco use and its impact on people's health, are issues that we have looked at over the years and obtained independent legal advice on over the years. In the context of doing the report, we did in a sense refresh that legal advice. We again went outside and obtained independent legal advice on some of those same issues to ensure that the view of the law, and what had happened in the courts in the meantime, had not changed that in any way.

Senator ALLISON—That legal advice came from where?

Mr Cassidy—We went to senior counsel to seek the advice.

Senator ALLISON—Who was that?

Mr Antich—We had advice from Jeffrey Hilton, but that was prior to this inquiry.

Senator ALLISON—That was three years ago or thereabouts.

Mr Antich—I am not sure if that is when it was, but we also got a significant amount of legal advice from our internal lawyers on the issues that were raised in various submissions and the issues that we looked at for the purposes of the report.

Senator ALLISON—Who did the subsequent advice come from?

Mr Antich—The legal advice that we undertook after this motion was passed was internal legal advice from our legal division. We have a number of lawyers, and we had internal legal advice on those issues.

Senator ALLISON—In the summary page of the report, you say there are allegations that tobacco companies have been involved in systematically misleading and deceiving consumers, in contravention of the TPA, through their alleged silence about the dangers of their products. How did you conclude that this was both 'alleged' and 'silence'. What led you to say that?

Mr Antich—Our understanding is that allegations were made to the commission along those lines. All we were saying was that the commission is aware that allegations were made in relation to that issue that tobacco companies were not disclosing certain risks of smoking and that there was certain information that the tobacco companies knew was not being disclosed to the public. All we were saying is that we are aware of those allegations, and such allegations were made to the commission.

Senator ALLISON—I would have thought that part of your role in advising the Senate on this issue would be to sort out the allegations. Given the 26 million pages of documentation on this issue and the number of legal proceedings that have taken place, I would have thought that you could do that business of sorting out allegation from fact. Was that not possible for the commission?

Mr Antich—I guess there are a number of ways I could answer that question. I think a central thrust, if you like, of the commission's report is that the material it had been provided with was not capable of providing the commissioner with solid leads to take an investigation further. Is that the point that you are addressing? I am just not sure.

Senator ALLISON—I guess the point of my criticism of your report is that not too much by way of allegation has been explored. Maybe we will move on to the question of silence. I would have thought that the documents that are available and that have been highlighted by those who did make submissions to you show very clearly that tobacco companies have very actively and very deliberately promoted controversies with regard to health impacts. They have remained far from silent, I would suggest to you, through the documents that are publicly available. Did you not find that?

Mr Antich—On the question of silence, it is in relation to what it is that is not disclosed rather than what is. I will rephrase that. The commission's view was, on the material that it had been given, that there was not enough material. This is I guess a point at which we diverge from ASH, and we are having ongoing discussions with them as to the sort of material that would be more productive for the commission's investigations. But on the material we were given there was not sufficient information for, firstly, further investigations on those issues, and secondly, on what we had been given, the likelihood of a successful action was remote. That was the view we took on what we had been given. As I said, we are having further dialog with ASH, with Jonathon Liberman, on the sorts of issues and information that could be more useful for what the commission is undertaking.

Senator ALLISON—Let me ask you what you discovered with regard to the question of the false controversy and the behaviour of tobacco companies in suggesting that, for instance, there were diverse scientific opinions about passive smoking or about nicotine dependence or a range of other health issues relating to smoking. You did not discover the documents that made that clear?

Mr Antich—I am not sure I can answer that question in terms of which documents you are referring to.

Senator ALLISON—I am asking you whether you discovered any.

Mr Antich—We looked and we made a number of searches of the databases then available, including the US one—and I cannot recall the name of that right now. But we did make searches. I think the media release referred to the commission making just one search but there were actually a number of searches that were conducted of documents. In addition we talked to a number of people about documents that they had provided to us and whether

they could give us some more. We got some more documents, but they were still not the sorts of documents we needed to take the matter further. That is the answer to that issue.

Senator ALLISON—You would have looked at all of the documents that were recommended to you by ASH and by other submissions?

Mr Antich—No, I do not think that is the case. I do not think we would have looked at all the documents that were referred to us if it numbered in the thousands or the millions of pages. I do not think we would have done that.

Senator ALLISON—And did it? Did the submissions suggest you look at thousands and millions of pages?

Mr Antich—I am not sure. I am not familiar with the submissions.

Senator ALLISON—Is there someone who is?

Mr Antich—Not to the level of detail that you are asking, but I can take that question on notice if you like.

Senator ALLISON—Perhaps the other officer on whom you rely for some answers might help in this respect.

Mr Antich—No, it is not possible to give that answer here.

Senator ALLISON—If you could perhaps take that on notice, that would be useful. Did you find any evidence that tobacco companies denied that smoking was addictive?

Mr Antich—I will have to take that question on notice.

Senator ALLISON—What about evidence finding tobacco companies targeted children in marketing cigarettes and smoking?

Mr Antich—Again, one of the issues relating to the commission's functions, given that is the scope of the notices of motion, is that it has to confine, if you like, its investigations to potential breaches of the act. In terms of your question, if that was not a breach of the act, or likely to be, it is not a matter that the commission can take further.

Senator ALLISON—I would like to come to that question a little later. The summary also talks about the fact that the commission—and you referred to this earlier—is conducting an investigation. Can you give the committee some idea of what that further investigation will be: whether you have terms of reference for it, internally; when you will complete it; and what scope it has.

Mr Antich—Which investigation are you referring to?

Senator ALLISON—There are a number of allegations that you suggest you will investigate further, and I think one of them is document destruction.

Mr Antich—Yes.

Senator ALLISON—When will you start that investigation and when do you expect to complete it? What are the terms of reference for it?

Mr Cassidy—This is an investigation as to whether there may be a breach of the act involved, so we do not have terms of reference for such investigations. Basically what we do is go through the normal evidence acquisition and forensic processes. At the moment we are talking to the firms involved, seeking to obtain the relevant documents.

Senator ALLISON—What do you mean by 'the firms involved'?

Mr Cassidy—The two legal firms and the British American Tobacco Company. Given it has been a matter in open court, we are rather hopeful that we will obtain the documents that we need without having to use our formal information acquisition powers, but we certainly would not rule that out if that is what we need to do.

Senator ALLISON—So you think there is a clear case of document destruction already established through the Rolah McCabe case? You would not doubt that question—or do you?

Mr Cassidy—No, in a sense the issue for us is not whether documents have been destroyed. We need to decide whether that destruction of documents has in some way or other resulted in people being misled as to what the effects of using tobacco might be. That is where the possible offence lies under the Trade Practices Act: it is the possible misleading or deceptive conduct involved; it is not the actual destruction of the documents per se.

Senator ALLISON—Yes, it is the reason for it.

Mr Cassidy—Yes.

Senator ALLISON—Again, you say in the summary that you are looking into allegations of document destruction. I find that an interesting use of language, given the very high profile case and the finding of the judge concerned.

Mr Cassidy—I take your point; it probably is a bit curious in the way we have framed it. But the reason why we use the terminology ‘allegation’—and you have used it a couple of times—is that in a sense the way we work is that we get complaints and allegations across a whole range of issues. Then it is a matter for us, through our investigations, whether we are able to obtain sufficient evidence to go to a court and, if you like, prove that allegation. Indeed, we are required by the government’s model litigant policy to go to outside legal advisers and actually get legal advice that we have reasonable prospects of success, before we can initiate a court action.

So in a sense we refer to ‘allegations’ in that it will quite often be the case that we suspect there is something there—I am talking in general terms here, not specifically about tobacco—but we are simply unable to obtain sufficient evidence to take the matter to court. Hence we use terminology of ‘allegations’ and ‘being able to establish a case,’ rather than the more black and white language of ‘it is either true or it is false’.

Senator ALLISON—Did you think about how tobacco companies might use that terminology for their own purposes? Might they say, ‘These are merely allegations; the ACCC says that is all they are.’ Did that occur to you?

Mr Cassidy—Indeed. It is not limited to tobacco companies. As you have probably observed, in the press we have quite a lot of people at the moment making those sorts of comments, but I am afraid that is the nature of our law enforcement work. We do not deal in black and white facts; we deal in allegations and whether we can then prove those allegations to the satisfaction of a court.

Senator ALLISON—You mentioned that this investigation will involve BAT and the two legal firms said to be associated with it. Given the kind of collusion which is pretty evident amongst tobacco companies globally and in Australia, why would you not look at other tobacco companies? I understand they have all been involved in document destruction to some degree or another.

Mr Cassidy—We may, but again, it is the constraints under which we operate under our act. We have to proceed on the basis of an allegation and the evidence we can gather, and if

that evidence then takes us to looking at other companies and other entities then that is what we do.

Senator ALLISON—Would it assist the commission if the Senate asked you to do so?

Mr Cassidy—That is again part of the problem. I am sorry that all of this sounds unhelpful; I do not want to sound unhelpful but they are real issues for us. A motion from the Senate does not empower us in terms of being able to use various provisions under our act. For argument's sake, a motion from the Senate does not give us the basis to use our compulsory information acquisition powers under the act, so whenever we are dealing with a motion from the Senate—and we have had three or four recently—we have to rely on the information we already have to hand or information given to us voluntarily.

Senator ALLISON—But surely your capacity to investigate does not depend entirely on your powers to acquire documents, does it?

Mr Antich—Yes, it does.

Mr Cassidy—It does, up to a point. Our compulsory information acquisition powers, which are set out in section 155 of the Trade Practices Act 1974, require us to have what is called a 'reason to believe' that there may have been a breach of the act before we can start saying to people, 'We require you to provide us with this information.' So the early part of any investigation is a matter of assembling what information we can, hopefully from people coming forward who are aggrieved about a particular issue and have certain facts and documents and so forth that they can give us. That is to get us to a point where our legal advice is that we have a reason to believe and therefore we can then use our compulsory information acquisition powers.'

Senator ALLISON—So your investigation will presumably take you to the documents which are already on the public record with regard to the sort of collusion which might mean that all tobacco companies in Australia might be engaging in this practice?

Mr Cassidy—It could do. In a sense you are asking where our investigation is going to lead, and we are always hesitant to volunteer that before we have actually undertaken the investigation.

Senator ALLISON—You seem to be fairly clear that your investigation would only involve BAT.

Mr Cassidy—No, that is where we have started, because that is information we have to hand.

Senator ALLISON—So you have not discounted the possibility that your investigation might involve other companies?

Mr Cassidy—No, certainly not.

Senator ALLISON—That is good to hear.

Mr Cassidy—A lot of our investigations start with a fairly narrow focus, but then they broaden as we get further into the matter.

Senator ALLISON—Do you see any urgency in this matter? Is it likely that the recent court case with Rolah McCabe would have encouraged some fairly hasty document destruction elsewhere, or are you of the view that this is unlikely?

Mr Cassidy—We do see a sense of urgency, although looking at the McCabe case in Australia and the Enron case in the US has led us to worries about document destruction in

several of the investigations we are undertaking at the moment. Indeed—although it is probably not something you want to get into—that was part of the background to our entering a number of oil company premises in Sydney in late April. So, yes, it does have a certain sense of urgency.

Senator ALLISON—I am sorry, I do not follow that point.

Mr Cassidy—The general issue which has been, if you like, brought to light about the possibility of documents disappearing was one of the reasons we decided to pursue the oil company matter in the way we did. But, as I say, that is probably a separate story. I am saying that that issue of document destruction has given a certain sense of urgency to not only this issue but also a number of other investigations that we have under way at the moment.

Senator ALLISON—I understand.

Mr Cassidy—I can certainly say we are treating this with a degree of urgency but, equally, we have a few others that we have to treat with a degree of urgency as well for much the same reason.

Senator ALLISON—I am sure you do. Can I move to page 4, where you discuss the time limit. With regard to possible claims based on addiction, you say that a three-year time limit in section 82 would mean ‘any application would most likely now be time barred’. Doesn’t that ignore cases that show there is no effective applicable time limit to applications under section 87(1) of the Trade Practices Act? I will give you, for instance, two cases: *Tanzone v. Westpac Bank* in 1999 and *Multigroup Distribution Services v. TNT* in 2001. Did you look at those cases with regard to time limit and, if not, why not?

Mr Antich—I will have to take that on notice.

Senator ALLISON—Okay. Would you agree that time limit restrictions in relation to part VA do not prevent action by the commission directly or indirectly to support private litigation exposing the conduct of the tobacco industry?

Mr Antich—I think that is right.

Senator ALLISON—You would agree with that.

Mr Cassidy—I think that would be right. The time limit is on our own action—which incidentally has been extended recently to six years as a result of amendments that were made to our act.

Senator ALLISON—Why then did you reach the conclusion that ‘any application would most likely now be time barred’?

Mr Antich—Which part of the report are you referring to?

Senator ALLISON—On page 4, you say ‘any application would most likely now be time barred’.

Mr Antich—Can you direct me to the passage on page 4?

Senator ALLISON—Line 6 of the first paragraph says: ‘any application would most likely now be time barred’.

Mr Antich—It is possible that some actions will be time barred and it is possible that some will not be.

Senator ALLISON—That is not what the report says.

Mr Cassidy—It does refer specifically to section 82 of the act. That means that, while there may be action possible, the possibility of getting damages under the Trade Practices Act is time limited.

Senator ALLISON—I have just given you examples of two cases where it was not and asked you about your own direct or indirect support on private litigation.

Mr Cassidy—I thought you were referring to another section of the act in giving those examples.

Senator ALLISON—One way or the other, your report suggests that there is a time limit on claims, and I am suggesting that those three instances are ways in which you would—

Mr Cassidy—We will get our legal people to look at those.

Senator ALLISON—Thank you.

Mr Cassidy—I should explain that different sections of the act provide for different forms of remedy. If the remedy is a damages one, which is what—say, if you look overseas—is common in tobacco related matters, then that is section 82 of the Trade Practices Act and it quite clearly does have a time limit.

Senator ALLISON—Perhaps it would have been wise to have mentioned the different sections and qualified your statement.

Mr Cassidy—We really need to get our legal people looking at those examples you have given us so we can come back to you with a substantive answer on that.

Senator ALLISON—Your report says that there was limited opportunity for litigation advice based on the existence of clear warning labels on tobacco products. Can I suggest to you that this finding is inconsistent with the fact that there is currently a review of health warnings on tobacco products. I think you refer to those on pages 28 and 29. Why would you say that litigation is unlikely because of the existence of clear warning labels? Isn't there, in a range of ways, a doubt about how clear they are and how effective they are? Why would you come to that conclusion?

Mr Cassidy—Both our internal and external legal advice is that, given the warnings that currently exist on cigarette packets—I am not saying that they are necessarily entirely adequate or whatever—and the general community discussion about the health damaging effects of using tobacco, we would have, in good lawyer terms, limited prospect of being able to establish in a court that someone damaged their health by using tobacco.

Senator ALLISON—Yes, I understand the argument.

Mr Cassidy—It is important because that is the legal point for us as to whether—

Senator ALLISON—But you have made a value judgement. You have said 'the existence of clear warning labels'.

Mr Cassidy—We have made a legal judgment and the legal advice is—

Senator ALLISON—You might have said 'the existence of warning labels', but to say that they were clear warning labels is a value judgment, is it not? You are saying that they are adequate; 'clear' is a word which you might interpret as being adequate and effective and so on. What I am suggesting to you is not only that there are doubts about the clarity and the effectiveness: we have the Department of Health and Ageing currently developing options for new health warnings. Why would you indicate that they are clear?

Mr Cassidy—Our legal advice is that for our purposes they are clear. That is not to say that they could not be clearer or they could not be better, which I think is the issue you are raising, but our legal advice is that they are clear enough to make it very difficult for us in a court of law. So there is a difference between saying whether you can make any sense out of them and whether, in fact, they could be better than they are.

Senator ALLISON—I think, Mr Cassidy, you are dealing in semantics here.

Mr Cassidy—Unfortunately, Senator, we are dealing with the law.

Senator ALLISON—I want to go to the McCabe v. BAT findings on the tobacco industry's use of the terms 'mild' and 'light'. Wouldn't you say that those terms are intended to be misleading and deceptive?

Mr Cassidy—Now you are into a second matter which we are investigating. This is a matter where we have got to the point where we have used our compulsory acquisition powers to obtain documents and other information.

Senator ALLISON—What led you in that direction? Why did you decide that those terms 'mild' and 'light' were worthy of investigation?

Mr Cassidy—We had complaints. I am not a technical person, but as I understand it the sort of complaint we had was that on the one hand, while mild and light cigarettes are lower in nicotine and tar, on the other hand there is what is called smoker's compensation. This means that a smoker actually inhales more deeply because of the low nicotine content so that the inhaling more deeply offsets the fact that there is less nicotine in the cigarettes. The complaint we had was that this was misleading because the ultimate effect was basically the same as smoking a normal cigarette because of that almost involuntary offsetting compensation. So that is what led us to start investigating.

During the course of our investigations there has been a decision in the US—in Oregon, from memory—on light and mild; exactly the same issue. So while there are difficulties in transferring or transposing issues from US law to Australian law, nonetheless, as part of our investigation, we are looking closely at that US case. But that is what led us to it: we had some complaints.

Senator ALLISON—So why would you not encompass misleading labelling such as 'low tar', 'mild', 'light' or whatever in the whole question of labelling? Why have you chosen to indicate that the clear warning labels on tobacco products are somehow separate from this question of whether 'mild' and 'light' are clear or not?

Mr Cassidy—I think there are two elements. I want to repeat my earlier point that, depending on how this goes, I would not rule out the possibility that 'light' and 'mild' might bring us back to the more general labelling issue. But the more general labelling issue is about whether adequate—or, in court terms, 'sufficient'—advice is being provided to people about the general health effects of smoking; whereas the 'light and mild' issue is more specific about something that holds out that 'light and mild' is a better form of cigarette for you, whereas in fact it may not be. So there are two separate issues.

Senator ALLISON—And you saw them as separate?

Mr Cassidy—Yes. I am not saying that one may not bring us back to the other, and—this is the nature of our work—we have not closed the door on the more general labelling issue. The problem is that, on what we are told at the moment, on the basis of the information that we have and of general community perceptions and knowledge, we probably do not have

particularly good prospects in court. But, of course, if we acquire additional information, that assessment could well change. It is about a whole lot of things. So we never actually close the door, but we park the issue until we see if we acquire additional information and additional evidence.

Senator ALLISON—Will the ‘mild and light’ investigation be parallel with the destruction of documents investigation, but otherwise separate to it?

Mr Cassidy—Again, they are two separate investigations, but if we find that the two somehow come together then they will come together.

Senator ALLISON—When you have considered both of those investigations, will you also look at the opportunities for litigation, as you are asked to do in this reference?

Mr Cassidy—That is a continuing exercise, which is why we flag in the report that we have these two investigations under way. If other issues come to us, we will investigate those as well. Really, the report is a bit of a snapshot at a point in time, saying: ‘This is what has happened in the past, and these are things that we currently have under way that we do not have a conclusion on yet.’

Senator ALLISON—Do you have a time frame for the investigations?

Mr Cassidy—No; I am afraid this is something that often annoys people, but with our investigations we do not have time frames.

Senator ALLISON—You do not flag the completion date.

Mr Cassidy—No. We try to do them as quickly as we can, but we do not know whether an investigation is going to take us, say, two or three months or, at the other end of the spectrum, two or three years, until we get into it and see what evidence and what material we can gather.

Senator ALLISON—How many officers are working on those investigations?

Mr D. Smith—I cannot say. It is not a matter of officers. In terms of where they are being done, I would like to suggest that one of our major offices, in Sydney, has that as a priority investigation. In Canberra, it is being handled by an enforcement branch.

Senator ALLISON—Perhaps you could take that on notice, about the work force. You say in the report that it is not your job to work out costing of the impact of smoking on health, repatriation and the like. Why did you form that view? I would have thought that it is part of the ACCC’s job to look after the public interest in this matter, as a consumer agency, and that it would be the role of the ACCC to assist the government in recouping some of these costs. Why is it so onerous, firstly—I have seen lots of estimates around which seem to have some basis—and such a difficult task? Secondly, why do you not regard it as being an important part of your work?

Mr Cassidy—To take your second question first, we are certainly not saying that this is not an important issue. What we are saying in response to the motion is that doing that sort of broad society impact work is not something that normally falls under our functions. It is something we may do if we had a substantial class action that we were taking and therefore we were into issues about damages and compensation. Even then, our work would probably focus on the particular group of people on behalf of whom we have taken the class action rather than what I would call a broader society type calculation. I am not saying that it is unimportant. It is not something that falls to us in terms of our functions under the act.

Senator ALLISON—Is this an onerous task? Is that what you concluded? Is that why you have not bothered doing it?

Mr Cassidy—I suppose we could simply look around at the other estimates and either report those or do some sort of average of them. But because of the sort of agency we are, when we put things forward, we like to be able to put our own name to them and be reasonably confident of the accuracy of them, if only in part because they may well be quoted back to us at some point in the future. I imagine that to start from scratch and do that sort of estimate properly could involve a reasonable amount of work.

Senator ALLISON—And you do not at this stage judge that reasonable amount of work to be justified; is that what you are saying?

Mr Cassidy—That is not what I am saying. I do not think it falls within the legislative constraints within which we work. It is just not something, unless it came up in the course of litigation, that we could, to be quite honest, find a head of power to do under the Trade Practices Act.

Mr Antich—Putting it another way, because this area is really focusing on the commission's enforcement role, the sort of costing that you are talking about is really a follow-through of an enforcement activity and litigation, and scoping at the end of the litigation process in terms of damages. It follows the investigation litigation process. It is not an independent thing that the commission does. The first option I am talking about is a follow-through of the commission's functions, whereas the second is not.

Senator ALLISON—Getting back to that question of litigation, you say:

... on current evidence there is limited scope for general legal action against tobacco companies under the TPA.

That was the conclusion you reached. I would have thought, from the documents that I have seen, that there is an enormous amount of evidence available that tobacco companies in Australia and their overseas parents have very deliberately conspired to engage in misleading and deceptive conduct for probably 25 years. I wonder whether you took the opportunity to look at the most recent litigation on some of that evidence. One would be the Philip Morris case, where they were ordered to pay \$282 million in March this year. Did you look at that case?

Mr Antich—I would think that we would not have looked at it before the completion of this report.

Senator ALLISON—A jury in the US found that a low-tar brand misled a smoker. The jury found that cigarettes sold as low tar are just as dangerous as regular brands and that the company had falsely represented the brand as healthier. Did you look at that case?

Mr Cassidy—No, I think that is the Oregon case that I mentioned we are looking at in the context of our light and mild investigation.

Senator ALLISON—Okay, what about the US Department of Justice web site? I can give you the web site address if that is useful. I would have thought that the documents that are on that web site—and I am sure that they do not run into 26 million pages but would probably be fairly discrete, if you like, in terms of what the commission was looking at—go to that question of the underlying conspiratorial conduct of US companies and BAT and Philip Morris in Australia? Did you look at them and did you not reach that conclusion?

Mr Antich—I cannot give you an answer as to exactly what we looked at, but I can say that there are obviously issues with looking at overseas jurisdictions and cases, and outcomes of cases—firstly, in particular, cases on appeal, and, secondly, because of the different jurisdiction, the US jurisdiction. Our focus cannot go beyond the Trade Practices Act, and what may be a conspiracy there may not be a breach of any law here. Those things will also come into consideration. We will not be able to look at everything that is arising out of overseas litigation, and that will constrain the usefulness of documents overseas—or any documents that are given to us, for that matter.

Senator ALLISON—I will come to that question of how similar Australia is with the US, in particular. Two cases since the report, of course, are the Myriam Cauvin case that commenced on 17 May, I understand, and, more recently, the case where the New South Wales health department is, I understand, challenging Philip Morris over sponsorship of rave parties for teenagers. That is happening in the Sydney magistrate' court on 11 June. Have you had regard to either of those issues?

Mr Cassidy—Both of those we are likely watching, but they are both cases in progress. The interesting bits in both cases are still to be revealed, so far as we are concerned, but we are watching those.

Senator ALLISON—Okay. As you mentioned, the conclusion in the report is that the US litigation could not be directly translated into the Australian context. How much analysis did you do of that transferability? It is not in the report. I wonder how much effort was put into that question, and why, in adapted forms, there might not have even been better opportunities in Australia for litigation? You may conclude that they are different, but why did you necessarily conclude that Australia is not in a stronger position?

Mr Cassidy—We had a look at it. They are a couple of issues. Firstly, we in Australia do not have anything equivalent to the unjust enrichment laws that exist at the federal level in the United States. It is those unjust enrichment laws that have played a particular part in at least some of the US litigation. The second issue that makes it more difficult here is that the whole process of taking class actions, in particular, the certification of class actions—that is to say, actually establishing who is in the class—seems to be a rather more difficult process through our courts that it is in the US. I suspect that is simply because, over the years, they have had more class actions in the US than we have had in Australia. In dealing with class actions, maybe our legal-cum-judicial system is—I was going to say 'still on a bit of a learning curve', but that is not the best thing to say.

Senator ALLISON—Does that suggest that there is a lack of experience yet or that we need to change the law? Does the Trade Practices Act need to be amended in order to provide unjust and enrichment laws that are stronger?

Mr Cassidy—It could be both. This is a class action issue. I do not think changing laws, in and of itself, is the answer in terms of class actions because, even if you change the law, if the courts are a bit reluctant about accepting broad based class actions then you still have an issue that you have to deal with in the courts. The third thing we observed in thinking about the translation from US to Australia is that a lot of these issues in the US proceed by trial by jury. A lot of the big damages awards in the US have been made in jury trials. In Australia we do not have nearly the same incidence of jury trials. I think I am right in saying that there is no provision in the Trade Practices Act which would lead to trial by jury.

Senator ALLISON—It is a pity that that was not discussed in the report in more detail. Did you look at the World Health Organisation consultation paper entitled *Litigation and public inquiries as public health tools for tobacco control*?

Mr Antich—Yes, we did.

Senator ALLISON—Why was that not mentioned in the report and why was there no discussion about the fact that clearly you did not find it helpful?

Mr Antich—We might have to get back to you on that but I would assume that we would not necessarily refer to every submission we got and state whether it was helpful or unhelpful.

Senator ALLISON—But this paper has a specific proposal on litigation. Isn't that central to your investigation?

Mr Antich—What would be central to our investigations would be evidence. Suggestions may be useful but they are not as useful, in terms of our purpose and our role, as evidence.

Senator ALLISON—There would seem to be a fairly significant limit on the amount of evidence that you looked at.

Mr Antich—It depends. The way we have to go forward in terms of our scope of activity will largely be dependent on evidence. Supposition and ideas about what the law ought to be will not necessarily be able to be acted upon. If someone has a view of the law—that it is a certain way and should be construed a certain way—and we take legal advice that the law is not as that person submits, our view clearly will be that it is not a goer, it is not something we can move forward on.

Senator ALLISON—The ACCC was specifically asked to investigate whether the documents that had been publicly released during tobacco litigation in the US contained evidence of contraventions in Australia. I put it to you that the ACCC has not done that. You say in your report that you looked at the US web site, www.tobaccoresolution.com, which has 26 million pages of evidence, and you concluded that you did not have the resources for an exhaustive search for evidence of contraventions. Why was it that, having looked at that very large web site—and I can image why it was daunting and that you would not want to go through 26 million pages—you then chose to do a search on 'Australia' and 'price'? What relevance did that have to your investigation?

Mr Cassidy—To clarify, we did do some searches on the 26 million documents. We did them for that part of the reference that refers to 'contained evidence of anti-competitive behaviour'. The further bit of that reference of the Senate motion which says 'all breaches of Australian law' is beyond power, so far as we are concerned. We cannot pronounce on whether something breaches another act that we are not responsible for.

We did do some searches using key words, which would be the sort of words we would be looking for in terms of anti-competitive behaviour, and basically it came up blank. We got little out of it. That is not to say that further probing of that database will not yield something. We are aware that there are a number of researchers, both here and overseas, who are in the process of doing just that so we are watching with some interest what results they obtain. We have already had an Australian researcher come to us to talk about some of what he has found in searching that material.

Senator ALLISON—What was the relevance of the search on 'Australia' and 'price'?

Mr Cassidy—I will defer to someone else on that.

Mr Antich—What we were looking for were documents that contained those terms.

Senator ALLISON—Why?

Mr Cassidy—For anti-competitive behaviour—which is within our power. We deal with things like price fixing and anti-competitive agreements. That is what our act is about and that is where our power lies.

Senator ALLISON—It is interesting that it has landed up in this report when that was not what you were asked to do.

Mr Antich—I am sorry, Senator?

Senator ALLISON—I can see why that would sit within your general interest in matters.

Mr Cassidy—That was what we were asked to do. In the second reference of the Senate motion are the exact words ‘contain evidence of anti-competitive behaviour’.

Senator ALLISON—How many submissions provided references that you could have searched but chose not to? You could take that on notice.

Mr Cassidy—We would have to take that on notice.

Senator ALLISON—Can I ask you about Professor Simon Chapman’s advice? Did you look at his work?

Mr Cassidy—Yes, we did.

Mr Antich—The officer who dealt with Professor Chapman is not here but there were a number of communications between him and Professor Chapman about the information that he had and there was some material that he sent us which was looked through. So there were discussions with Professor Chapman.

Senator ALLISON—Given that Professor Chapman has a grant for a three-year study of tobacco industry documents and has, fairly publicly, made some comments about unconscionable behaviour, and so on, of tobacco companies, did you not agree with the documents that he made available? Did you not agree with his assumptions?

Mr Antich—I will have to take that on notice.

Mr Cassidy—There is an issue, incidentally, about unconscionable conduct, which is an offence under our act. But the way in which it is drawn under our act envisages a transaction between two people where there is an imbalance in bargaining power between the two people. For that to apply in this situation we would need to get a transaction between, say, a tobacco company and the consumer—the person smoking the cigarettes. The actual transaction occurs between retailers and consumers so, given the way in which those unconscionable conduct provisions are drawn—which are meant to be provisions about commercial bargaining—they are a bit hard to apply to more general retailing type situations.

Senator ALLISON—I would like to come to that point a little later. The report does not suggest that there are opportunities for the ACCC to participate in private litigation. Can you confirm that it is the case that the ACCC could intervene and that the cost liabilities in intervening would be minimal in so far as you would be responsible just for your legal costs? Have you considered that? Would you consider it for the cases which have been more recently instigated? Is it possible to have some advice about the prospects for that?

Mr Cassidy—As a general proposition we certainly consider intervening in particular cases. Normally, I must say, we intervene where we think that there is, if you like, a broader

issue involved in the case. In terms of your statement about costs, in one sense that is right, but I must say that in the past we have had the experience of intervening in a case and then finding that the original respondent, if you like, reaches a settlement with the other party and withdraws, so we are then left with the entire case. That said, we will have a look at these cases that are on foot to see whether there is a case for us seeking to intervene.

Mr Antich—The only other thing I would add about costs is that we do not usually find that they are minimal, and certainly if we are unsuccessful we have to wear the costs of the winning side.

Senator ALLISON—Yes, but that is not the case where you intervene in a case which is already under way between two other parties.

Mr Cassidy—It is, and this is why I was making the comment, because we have found ourselves in the position. If we intervene in a case, given that we are a much bigger player in these things, we find that the willingness of the defending company, if I can put it that way, to settle with the original applicant increases somewhat, so we are then left running the case, and in that situation we are potentially liable for the other party's costs.

Senator ALLISON—But there is no discussion about that in the report.

Mr Cassidy—That is the sort of motive of legal practice, if you like.

Senator ALLISON—Going back to the question of the labelling standards, you say that the health dangers of smoking are disclosed to consumers through mandatory labelling standards. Did you come across any evidence of the industry's counter campaign, if you like, on labelling?

Mr Antich—What do you mean, Senator?

Senator ALLISON—I mean a counter campaign, one which seeks to undermine the mandatory labelling requirement.

Mr Antich—I might have to take that one on notice. I am not sure. We cannot answer that currently.

Senator ALLISON—It would be useful to get some advice on that because I am sure we can all point you in the direction of some documents which would suggest that there was such a campaign.

Mr Antich—As I mentioned earlier, we are in discussion with ASH and Jonathon Liberman as well about issues they have raised in response to this report, and we will be discussing that.

Senator ALLISON—You also say, 'The ordinary or reasonable consumer of cigarettes is generally aware of the dangers.' What is the test for whether or not conduct is misleading or deceptive?

Mr Cassidy—The basic test is whether what has been said, what has been advertised, would overall create a misleading impression, so it is the impression that is given rather than the precise form of words or precisely what is in the particular TV advertisement.

Senator ALLISON—Section 52 does not mention anything about 'reasonable consumer', does it?

Mr Antich—That is the test that the courts apply to that section. That section is clear in terms of its words. In terms of the way it is interpreted by the courts, that is the test that Mr Cassidy has mentioned.

Senator ALLISON—Surely the courts would look at classes of person, would they not? They would not conclude that a reasonable consumer had to be identified and that they would be the only class of person, if you like. In other words, isn't the test relative; it is not absolute?

Mr Cassidy—Yes.

Mr Antich—Again I am talking in general terms, but supposing you had something that was obviously targeted at a particular group, say a minority group of some description, then the court would take that particular group as being its reference.

Senator ALLISON—But tobacco is directed at the public at large. Apart from tending to want to persuade young people to smoke, the tobacco industry message goes to the broadest public audience, does it not?

Mr Cassidy—The court would look at the general impression that is given to the community at large.

Senator ALLISON—How do certain classes of people fit within the classification of the 'ordinary and reasonable consumer'—for example, those who are not so intelligent or not so well-educated, people who are gullible and not reasonable, children, and groups in this country whose smoking rates have dramatically increased, like indigenous people, where smoking rates for men are now well over 50 per cent? How do they fit within the 'ordinary and reasonable consumer' category?

Mr Cassidy—My colleagues can correct me on this, but given that we are talking about advertising directed towards the general community, to get the courts to focus on those particular groups, either individually or collectively, we would need to be able to make some sort of argument that while this advertising might have been general community advertising in one sense, it was in fact specifically directed at those particular groups.

Senator ALLISON—And you found no evidence that tobacco companies directed their marketing towards children?

Mr Antich—No, based on the material we have been provided with we did not think there was evidence to take it any further.

Senator ALLISON—On the material you have been provided with or the material you looked at? You are saying that no material provided to you led you to the view that tobacco companies marketed to children? Can you say that categorically?

Mr Antich—There is an issue there as to whether that is a contravention of the act as well, and that is also relevant to the issue.

Mr Cassidy—It is all getting back to our earlier discussion. I am afraid you keep portraying things in black and white terms whereas we, as law enforcement people, keep thinking in terms of allegations and then what can be substantiated in a court of law.

Senator ALLISON—But, Mr Cassidy, your report says 'the ordinary or reasonable consumer of cigarettes is a generally aware of these dangers'. I did not say that; that is a pretty black and white statement. I am suggesting to you that there is no ordinary and reasonable consumer of cigarettes when it comes to the way in which tobacco companies market their product; they do not market their product to ordinary or reasonable consumers.

Mr Cassidy—But what I am saying to you is that we have not yet reached the position where we believe we can argue successfully in court that even though advertising is basically general community advertising it is in fact directed to a particular group. We would need to do

more than establish that this general community advertising is done in a way that perhaps has particular appeal to a particular group. We would probably need to go beyond that and say that this advertising was intended for this particular group of people. On the basis of legal advice we have got we do not believe that we can mount that sort of case yet.

Senator ALLISON—I would be interested in you checking that legal advice, because it is my understanding that the courts have already held that the prohibition of misleading or deceptive conduct exists so that action can be taken under a general provision where there is a lack of specific legislative or administrative action. I will give you an example: *ex parte Pilkington ACI (Operations) Pty Ltd (1978)*, especially Justice Murphy's comments, which were cited by Burchett in *Australian Federation of Consumer Organisations Inc. versus The Tobacco Institute of Australia Limited (1988)*. Perhaps you could go back and have a look at that.

Mr Cassidy—We would certainly be interested in that. I think we need to give some considerable thought before handing over our legal advice. It is not something which is commonly done and indeed we are being fought up hill and down dale in the High Court at the moment over the reverse of—

Senator ALLISON—I did not ask you for your legal advice.

Mr Cassidy—I thought you did.

Senator ALLISON—I just asked you whether those matters were taken into account.

Mr Cassidy—We will have a look at those.

Mr Antich—In relation to the allegations about marketing to children, we certainly did consider those issues and the evidence that was provided to us, and we did not think that they went very far so we did not take that matter any further.

Senator ALLISON—I think it would be interesting to get from you an analysis of that documentation, especially some of the more high profile, well known public documents, to give some indication of why you came to that conclusion. I will move on to the legal advice. It says:

... the courts are likely to take the view that consumers are aware that cigarette products are likely to be inherently dangerous and capable of causing a wide range of illnesses/diseases, not all of which may be specifically outlined by tobacco companies on their packaging.

Doesn't that ignore the whole notion of consumer protection, which is what I understand your commission to be about? Doesn't the fact that you cannot physically fit all of the illnesses and diseases onto a cigarette packet demonstrate that the warnings are not adequate?

Mr Cassidy—I think I can only repeat what I said earlier. There is a difference between whether the warnings are as good as they could be and whether they are sufficient to indicate to people that smoking will potentially damage their health.

Mr Antich—Another thing to add to that is that the conduct we investigate relates to the conduct of corporations in trade or commerce and the labelling is a separate issue, to some degree, to the actual conduct of the company.

Senator ALLISON—But it was central to your finding that litigation was unlikely, because of the labelling. It keeps bringing it back to this question.

Mr Antich—The labelling is an issue related to disclosure and what people are aware of in terms of using a tobacco product.

Senator ALLISON—Yes, but you have said the labelling is the reason why you feel litigation is not likely to proceed. We have gone over this a dozen times so I will not keep on saying it, but I do not think you can say that—

Mr Cassidy—Let us be clear: we are not saying that the labelling could not be improved. I think that is a point of difference; we are not expressing a view on that.

Senator ALLISON—Yes, we have had that discussion. You say on page 5:

The Commission has also been made aware of allegations that the sale of cigarettes to children in certain circumstances may amount to unconscionable conduct under Part IVA of the TPA ... when ... one party to a transaction suffered from a special disability or disadvantage in dealing with the other party ... Surely you do not need a transaction or a party to a transaction to suffer in order to demonstrate unconscionable conduct?

Mr Cassidy—There are three unconscionable conduct provisions in the act: sections 51AA, AB and AC. Section 51AA is based on the unwritten law of the states and is basically about where someone has a particular disadvantage; 51AB and AC are based on the notion of where there is an imbalance in bargaining power between the two parties. In terms of the issue being raised here, it is probably section 51AA which is the potentially relevant section.

Senator ALLISON—But 51AB makes it very clear that the prohibition of unconscionable conduct is unqualified. It says that the circumstances in section 51AB are intended to operate:

Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation has contravened subsection (1) ...

I would have thought that was very clear with regard to unconscionable behaviour and not requiring transactions, parties to transactions, disabilities or anything else.

Mr Antich—I am aware of Mr Liberman's views on this section. Jonathon Liberman has a similar view to the way in which this section should be construed. There are a number of difficulties with that. In terms of the way unconscionable conduct is construed, it relates to the factor of interaction between two parties to a transaction. It does not take the view when you have a manufacturer, an end user and parties in the middle. Section 51AB(6) says that 'the possible supply does not include a reference to supply or possible supply for the purposes of resupply'. So our legal advice suggests that transactions of the type that are being raised are not envisaged in that section.

Senator ALLISON—Are you saying that for a tobacco company to engage in conduct that influences the supply from the retailer to the child or the acquisition of cigarettes by the child from the retailer can never be described as unconscionable; is that your conclusion?

Mr Antich—I would think that it is less likely than more likely. From the way this section is drafted, I do not think that is the sort of conduct that is aimed at. It looks at transactions between parties directly where there is overbearing will or conduct which affects the bargain. I do not think that sort of conduct is captured by this section in the comment you are referring to.

Senator ALLISON—Your legal advice leads you to that conclusion?

Mr Antich—Also our experience in the courts.

Mr Cassidy—And court decisions. We are testing these sections in the courts and that is the sort of decision that we are getting.

Mr Antich—We basically had a brief in 1997 to take a lot of cases on in relation to unconscionable conduct and to test the law. We have been actively doing that. Only last week, we received special leave to go to the High Court on an unconscionable conduct matter. There are a number of matters involving disadvantaged parties in regard to door to door sales and the taking of money by franchisees. In a lot of different situations we are trying and testing the law. It is not that we do not take a wide view or that we are not trying to test the law in this area; it is that the sorts of issues you are raising are not the ones that are considered within that section.

Senator ALLISON—On the question of the merger of British Tobacco and Rothmans, you say that it did not pose a problem in lessening competition once the loose tobacco brands had been divested to Imperial. Did you consider Imperial's role in bringing together seven of the world's major tobacco companies in 1971?

Mr Pearson—We considered the state of competition in Australia and the state of competition that would exist following that divestment. That was a relevant factor in deciding what the competitive outcome would be.

Senator ALLISON—This is not so much a question of mergers but rather a question about whether tobacco companies act in concert. I would have thought that the ACCC should be focused on the question of Imperial's role in misleading and deceptive conduct in this instance, because this is what this report is about. With regard to those mergers, did you not consider Imperial's role in the collusion that occurred in bringing those tobacco companies together?

Mr Cassidy—The merger provision is drawn in terms of whether the merger or acquisition would result in a substantial lessening of competition. That is the criterion which the act says that we have to take into account.

Senator ALLISON—I am wondering what the relevance of it was with regard to this report?

Mr Antich—Again, it is within the terms of reference of the motion to look at anti-competitive behaviour. Aspects of anti-competitive behaviour include part IV of the act which relates to mergers between companies in markets within Australia. We had to report on that issue as well.

Senator ALLISON—When those seven companies came together, you did not find, through the various documents that minute the 'secret' meetings—I might say—of those tobacco companies, that there was any initiating behaviour which Imperial might have been responsible for? You did not find any relevance or concern relating to its involvement in anti-competitive behaviour through this means?

Mr Antich—I cannot really speak for all the documents that would have been looked at in terms of a merger matter. Generally, those documents will be confined to the material that is put before us by the parties to the merger and the market inquiries that the commission makes. The commission generally, I would say—I can be corrected on this—would not adopt the practice of seeking documents under section 155 of the act in relation to a merger. That is not its normal practice.

Senator ALLISON—I understand that. But, for the purposes of this investigation, surely that would be of interest.

Mr Antich—It is going to be hard to determine which documents will be of interest and which documents will not be of interest.

Senator ALLISON—Let me ask you directly: did you look at the documentation of that initial meeting and subsequent meetings in 1971, which took place in the UK, which were instigated by Imperial and at which seven of the major tobacco companies world wide met and agreed to strategies to undermine health and scientific studies into the impacts of smoking, labelling and a whole range of strategies being adopted around the world? Did you look at that documentation?

Mr Antich—I cannot answer that here. We will have to take that on notice.

Mr D. Smith—We will take that on notice.

Senator ALLISON—Thank you. Can you also indicate what you know about the national manufacturers associations, such as the Tobacco Institute of Australia, and their practice of acting in concert? Please take that on notice as well. Thank you for your indulgence, Chair.

CHAIR—Thank you, Senator Allison. Senator Sherry, even though you have some questions, I wonder whether we might interpose ASIC at this stage.

Senator SHERRY—My questions are for ASIC.

CHAIR—So you have no questions for the ACCC?

Senator SHERRY—No.

Mr Cassidy—Mr Chairman, just to clarify: as far as you know, is that the end of questions on tobacco?

CHAIR—Not only that but I think that is the end of all questions for the ACCC. Senator Sherry has none, and neither Senator Watson nor I have any.

Senator Ian Campbell—I think Senator Conroy is putting his questions on notice.

CHAIR—Subject to the receipt of Senator Conroy's foreshadowed questions on notice, I excuse the officers of the ACCC. Thank you, gentlemen. I call to the table officers of the Australian Securities and Investment Commission.

[6.13 p.m.]

Australian Securities and Investment Commission

CHAIR—I welcome to the table officers of the Australian Securities and Investment Commission. Mr Knott, would you like to make an opening statement?

Mr Knott—No, thank you, Chairman. But we thought that tonight we should just make ourselves available for questions from the members of the committee.

CHAIR—Thank you very much indeed. We will commence with Senator Sherry.

Senator SHERRY—Mr Knott, certainly you and Mr Johnston were present earlier when I was questioning Treasury officials about the Financial Services Reform Act, as it is proposed to apply to the regulation of superannuation fees and charges. Is it your understanding that the ongoing management charge that is proposed with the regulatory regime will not include some categories of entry fees, exit fees and contribution fees?

Mr Knott—Yes, that is my understanding.

Senator SHERRY—The impact of this exclusion and the outlining of those fees are in another part of a document. So you have two sets of fees disclosed in two parts of what can be

quite lengthy documents. I put it to you that I see two problems here. One is the consumer being able to identify the total fee: putting two sets of fees together and trying to work out what the total fee is; and, secondly, their being able to identify two separate fees and charges in a document.

Mr Knott—I understand the issue you are raising. To put it in context, the important thing for the Senate to understand is that, as was made clear by previous testimony, the issue of prescribed disclosure is clearly a matter of policy that has been decided by government. We as a regulator, therefore, are in a position of implementing that policy. We have instigated a process of looking at potential disclosure going forward to see whether there is a way of developing more consensus within the industry sectors and the consumers towards different types of disclosure. But I want to make this point very clearly: in a sense, it is a facilitating role we are playing and not a legislatively mandated role. In the end, as I think was very clear from previous testimony today, it is a matter for government to decide whether the existing disclosure requirements are adequate or need to be changed. I understood the minister to be saying that the government's present preference was to bed down what is there over the two-year transition period and, at the end of that time frame or at some stage through that time frame, review any further need for change. We will, as I say, try to facilitate a discussive process so that perceived deficiencies in existing disclosure can be identified and to see whether we can bring parties closer together. But that is where we are placed at present.

Senator SHERRY—In the context of this issue of superannuation and in terms of the sums of money involved, even if it is only SG, you do understand that we are dealing with a compulsory product concerning some very substantial sums of money and about eight million consumers who will be impacted in terms of the fees and the charges, about which they will be expected to make an information decision.

Mr Knott—I do understand that, and I understood the previous testimony today to give that as the reason why there is a different approach between superannuation disclosure and other managed investment disclosure. But I also understand, and fully agree, that there are issues about the existing model of disclosure that are raising concerns between different groups and which you are expressing. I just reiterate my view that, in the end, this is a matter that only government can determine.

Senator SHERRY—Again in respect of superannuation, is it your understanding that, whatever the total of the fees and charges in this area, however calculated and however disclosed, they are not required to be reported to a body such as ASIC or APRA?

Mr Knott—Yes, that is—

Senator SHERRY—And, in turn, you can publicly disclose, I think in a neutral way, what the facts are in this area, as distinct from having to rely on industry organisations doing surveys, which are not necessarily representative or comprehensive—and they are certainly not independent.

Mr Knott—I hope you will forgive me if I defer a comment on the second part of the question, which is observing on the quality of the current reporting by industry groups. I would have to say that, personally, I do not know enough about that to make a considered judgment. But, on the first part of the question, it is quite clear that we do not have a role to collect statistics on fee information or to publish such statistics.

Senator SHERRY—The only point I would make about that is that I think APRA has dobbed you in for the job as being the most appropriate organisation to do that in this area.

Mr Knott—We are always grateful for support from APRA.

Senator SHERRY—I have slightly greater confidence in your capacity to do it than in APRA's—but that is a debate for another time. We had a discussion about solicitors' mortgage funds on the last occasion, and you indicated that there were ongoing investigations in Tasmania and Queensland and that these were going to take place during the course of this year. Is there anything further to report in respect of Tasmania?

Mr Knott—Yes, quite a lot has happened, and I might pass in a moment to my colleague Mr Johnston. A particular firm was discussed when we last met: Piggott Wood and Baker. There is legislation in the Tasmanian parliament at present—

Senator SHERRY—We have been informed of that.

Mr Knott—and we are very hopeful that that legislation will not only give access to compensation to investors who have lost through that scheme but also significantly enhance the power of the liquidator to take action. So, at the moment, the outlook for those investors is very good. But, for a more general answer, I defer to Mr Johnston.

Mr Johnston—The other thing that we would add in respect of Piggott Wood and Baker—and which I think we neglected to mention last time—is that we were able to achieve an outcome with one of the financial planning firms in Tasmania which had the investors repaid the money that the firm had invested on their behalf into Piggott Wood and Baker.

Senator SHERRY—Garrisons.

Mr Johnston—Other proceedings have taken place in Tasmania. Further schemes have been wound up. By the same token, further schemes have been wound up in Queensland also. In respect of some of those matters, some issues are before us just now for determination as to a litigation strategy.

Senator SHERRY—So there are still some matters awaiting determination as to the path forward?

Mr Johnston—Yes.

Senator SHERRY—And you cannot detail them?

Mr Johnston—No, we cannot.

Senator SHERRY—I understand. Do you have a possible date for that?

Mr Johnston—A decision for one is imminent as to what course the commission might take.

Mr Knott—May I add that, since we met, we have issued a press release in terms of the overall outcomes of the whole national investigation. You will have seen from that that the amount outstanding in default has been greatly reduced. The number of schemes outstanding has been greatly reduced. We are really now in the rump of this process in dealing with those outstanding potential enforcement matters which may lead to prosecutions or further winding-up orders. There are some to be dealt with, but we would say the bulk of this work is now behind us.

Mr Johnston—The other thing that we should perhaps add is that there are some policy outcomes as well. There are some further guidelines and requirements that we will be publishing in respect of how mortgage schemes generally—not just solicitors' mortgage schemes, because they are running out, of course—should appoint valuers, how the valuers should behave, what they can take into account et cetera. That will be issued shortly.

Senator SHERRY—Can you give me an approximate time frame for these new things?

Mr Johnston—That would be in the next few—probably two or three—months.

ACTING CHAIR—I wanted to say thank you very much for your timely intervention, because I think it has helped resolve the solicitors' mortgage issues very satisfactorily. But there is one accounting firm which fell into a practice similar to those of the solicitors' mortgage funds and which is outside the scope of the legislation. I think you are aware of that. I have heard a criticism that some people are having difficulty getting some feedback on what is happening in that area. Perhaps you might like to take that on notice and examine it for us. It is in relation to an accounting practice that adopted similar practices to those of the solicitors' mortgage funds.

Mr Johnston—We would have to take that on notice. We might also need to seek further details from you.

ACTING CHAIR—Yes, and you will have to be careful how you respond too. That is why I have put it in the way that I have.

Mr Knott—That is a mortgage practice run by a firm of accountants?

ACTING CHAIR—Very similar, yes. And it ran into difficulties. Senator Sherry, did you have another question?

Senator SHERRY—No, I am finished.

ACTING CHAIR—Mr Knott, could you update the committee on your involvement with Commercial Nominees? I understand that you were overlooking one of the entities where you believe it is likely that there will be an 80 per cent return to members.

Mr Knott—That is correct, but for further information I would like to refer the question to Ms Redfern, who is directly responsible for the management of that investigation.

Ms Redfern—You mentioned the Confidens Investment Trust. I might just backtrack to talk about our involvement with Commercial Nominees over the last 18 months. When we first commenced investigating this matter in December 2000, we froze assets that were in the ECMT. We seized documents. We also investigated and took steps to wind up and appoint an independent receiver to the Confidens Investment Trust. Those proceedings have proved to be quite complicated. There have been significant issues that have had to come before the court. We have been monitoring those. We do oversight those issues, but most particularly the court has been overlooking those issues. The receiver has been reporting to the court on a regular basis. It has been a very complicated process because of the inadequacy of documents and records, but the matter is before the court on 14 June for directions from the court about distributions. We understand and expect that the distributions will be in the vicinity of an 80 per cent return and that the distributions will be able to be made very shortly after the directions hearing.

Senator WATSON—APRA reported to the committee this week that you are liaising with them with a view to possible action. Given the operation of the statute of limitation, some of us have concern, particularly in relation to events which date back as far as 1997. Would you like to comment?

Ms Redfern—We are aware of that matter and we became aware of the matter after we commenced our investigation and uncovered the issue that you are talking about back in 1997. The event that occurred back in 1997 really did not relate as such to the Commercial Nominees losses that we have been talking about.

Senator WATSON—That is when their problems commenced, though, wasn't it?

Ms Redfern—Yes.

Senator WATSON—That was the beginning of the dilemma that seemed to grow exponentially.

Ms Redfern—From our investigations, we have identified that the big losses that ECMT suffered really started around 1999 and 1998.

Senator WATSON—The big ones, yes.

Ms Redfern—You are right. We have been investigating transactions in 1997. It is not always easy when transactions are quite old, when they first come to your attention some four years later, but we have been investigating those. We have been discussing those matters with the DPP. We have not finalised those investigations. We expect to finalise those shortly. We are at the end of the end stages of our investigations. Our investigations have been broader than that, though. We have investigated more recent events in Commercial Nominees, particularly in relation to the Confidens Investment Trust.

Senator WATSON—Mr Knott, you have claimed that accounting and auditing have failed to deliver acceptable outcomes. You go on to say that 'amongst many complex factors is the content and style of accounting standards and the quality of the audit process, which all raises queries regarding audit independence'. Since you made those very important statements, the accounting professions have changed their attitude to the standards in terms of what is required—in part, the rotation et cetera. Mr Alfredson, the Chairman of the Accounting Standards Board, was before us yesterday. He indicated that, in relation to a possible problem—which is AS118 or thereabouts—with financial performance, there were problems of too great a flexibility, which enabled comparisons between entities to be fairly difficult. ED105 does address the more urgent of the issues, but it is still only an exposure draft. I would like your comment on what has happened since you made those comments. Do you have more confidence in the system now than you had when you first made those comments—that is, in relation to the most recent pronouncements?

Mr Knott—I think there has been a sea change in sentiment in the last few months. One cannot underestimate the impact that Enron's collapse has had on thinking both within Australia and, of course, internationally. I think the accounting profession, by and large, has moved a long way in its thinking. I believe it is much more open now to ideas and proposals for change practices—for a new look at accounting standards and for a new look at the way those standards are audited. I think the debate still has a way to go before we can be totally confident about the outcome. Of course, part of that debate will involve this government's response to the issues, and we would expect to see that perhaps as part of the process that the minister described earlier when he was talking about looking at a whole range of disclosure issues. So, the broad answer to your question is: yes, there is a greater confidence, built on the fact that the profession itself is more open to ideas than it was initially, and also built on the fact that the public and political system is much more attuned to these issues now than it was 12 months ago.

Senator WATSON—Thank you, Mr Knott.

Senator CONROY—I have been told that Mr Mackintosh may be on an earlier plane and he has to go. It is also his last day, I understand, and so I want to wish him all the best at the World Bank—and congratulations.

Mr Mackintosh—Thank you very much, Senator.

Senator CONROY—I want to follow up on some conversations I was having about international accounting standards and ask you where you think that is at at the moment. You may be aware that, in discussion with Mr Alfredson yesterday, I made reference to IOSCO's deliberations, particularly on executive remuneration disclosure. It may be that Mr Knott wants to field that question. But could you give us a brief update on where you think the international accounting standards are at and how they are going?

Mr Mackintosh—I think the new International Accounting Standards Board—I say 'new' but it is not brand new now—is doing a very thorough job and has stuck to the timetable that it originally set out. It has just produced a 400-page document of what is called its 'improvements project', which looks at a whole raft of standards. So I think that side of it is going very well. It is very hard to measure how people will take up those standards. The Europeans have indicated that they will pick them up by the year 2005. The Americans are not making similar commitments at this stage, and I would say that opinion in the United States is fairly well divided on whether they should or should not adopt international standards. I think the board needs to press on in the manner that it is doing at the moment. I think the Europeans need to stick to their resolve—and it is pretty well entrenched resolve through the European parliament and the like. Then I think the rest of us should be working to the same goal.

Senator WATSON—But that is not until 2005, is it?

Mr Mackintosh—It is 2005, with it to stretch out to 2007 for a bit of—

Senator CONROY—I appreciate that in the US there is still significant resistance, despite the manifest failings of their own system. Also, I think some changes in the accounting setting procedures were announced.

Mr Mackintosh—And also in the US, there is a new chairman of the FASB. They have come off the international board to become chairman of the FASB, which is an interesting development in itself.

Senator CONROY—When you say that opinion is divided, is opinion divided in the accounting community in the US or is it divided among the regulators who will make the decision?

Mr Mackintosh—I think you have to include business as well. Business, the accounting profession and the regulators make up a big pool.

Senator CONROY—I think business is saying, 'Over my dead body,' and we are just pointing to Enron.

Mr Mackintosh—I think there is still a sentiment amongst some in the US that they have the best standards in the world and why would they want to change them.

Senator CONROY—Do you think any more profit downgrades might give them a hint?

Mr Mackintosh—Yes. I think there is a shift in the US as well. We should not be too depressed about it and we should not expect them, I do not think, to instantly embrace international standards, but I think there will be a gradual move over a period of time and I think the Europeans adopting them will be a great influence.

Senator CONROY—Does the World Bank have any influence in this area?

Mr Mackintosh—The World Bank has real interest—whether it has influence is another thing.

Senator CONROY—We are hoping that, with you in there batting, it gets the interest and the influence.

Senator WATSON—Actually, the World Bank have a new focus on the role of auditors.

Mr Mackintosh—That is right, and in governance in general.

Senator CONROY—You will be working on that?

Mr Mackintosh—Yes.

Senator CONROY—You may even get an email from me.

Mr Mackintosh—I will look forward to it.

Senator CONROY—It is your worst nightmare! ‘You’ve failed me!’ I just wanted to get a quick brief and say good luck.

Mr Mackintosh—Thank you.

Proceedings suspended from 6.38 p.m. to 8.05 p.m.

CHAIR—I call this meeting to order.

Senator CONROY—Mr Knott, I note a press release from ASIC today outlining some penalty orders for Messrs Adler, Fodera and Williams. I am wondering if you could briefly take us through that. Could I start by congratulating ASIC on its outcome. It is good to see.

Mr Knott—Thank you, Senator. Today’s orders really resulted from the subsequent hearings to Mr Justice Santow’s orders in the PEE matter which received a degree of publicity. The defendants in that case, particularly Mr Adler, had made an application for a stay of the sanctions that had been imposed. That application was heard over the last two days and His Honour this afternoon made a number of rulings.

In essence, he stayed orders against Mr Adler and Adler Corp until 3 July, so quite a short period. He imposed additional undertakings in relation to the non-disposition of assets to ensure that there would be security against the orders that had been made. He ordered that Messrs Adler and Williams would be held jointly liable for the compensation that he had previously ordered and that all four defendants in the case—that is, Mr Adler, the Adler Corporation, Mr Williams and Mr Fodera—would be liable for costs. It is in effect the conclusion of the hearings into this matter, subject to any appeals that Mr Adler or other defendants may successfully make. I think the important thing to note is that, come 3 July, the orders made by His Honour will be effective.

Senator CONROY—Do you have further action pending in this general area? I appreciate there is a royal commission on, but I think you remember we have had some discussions about how the interaction was going to work—whether you have to put matters on hold. Could you take us through that as best you can without getting both of us into trouble?

Mr Knott—I appreciate your sensitivity to the situation. It is one that I prefer not to say a lot about. The investigation into the PEE matter has not been concluded in the sense that it is possible that further action in relation to those transactions could eventuate. In relation to the HIH investigation generally, it is continuing. It is continuing in parallel with the royal commission. In a sense our investigation is informed by the evidence being given at the royal commission. Of course, the royal commission itself has been substantially assisted by the

information provided to it by ASIC. The two proceedings, as it were, are continuing in parallel. I think it is a bit premature to say anything about likely outcomes at this stage.

Senator CONROY—Are you able to collect information as part of the royal commission? I know we had this discussion way back before it started. I just want to get an understanding of how you are meshing together. Are you conducting the investigation jointly? I think I did read somewhere that in some cases you are actually conducting the interviews.

Ms Redfern—I might deal with more of that sort of detail. I think, as Mr Wood said on the last occasion, there have been quite a few synergies. It is also fair to say that we did a lot of concentrated investigation between April and September of last year. A lot of that information was provided to the royal commission and has been really the subject of a lot of the matters that are currently before the commission. I think the main opportunities for synergies are for us to sit through some of those hearings to see some of the witnesses and to see some of the issues that emerge. Mostly the documents have been collected by us in the early stages. I think we answered a subpoena from the royal commission where we had to actually notify, as part of the procedural fairness issues, 250 people. So those were the people we had collected documents from and examined.

Senator CONROY—And did they feel the need to subpoena you, or was that just the legal process they had to go through?

Ms Redfern—That was the process adopted by the royal commission.

Senator CONROY—Were you not cooperating?

Ms Redfern—Not at all. I think they just subpoenaed quite a number of people in September and October. We were one of the parties and we produced a vast amount of material. To again talk about the detail of it, a lot of the issues that have emerged are issues that, as the chairman says, have been part of the parallel investigation issues that we have been looking at, have been investigating and are currently investigating.

Senator CONROY—Without wanting to rain on your parade, I noted some commentary today in the *Business Review Weekly*. I do not know if you have had a chance to see that. It raised a couple of questions. I thought you might want to take this opportunity to respond. The highlights are: you were officially told about the trust on 22 December 2000, yet you waited until after HIH collapsed some months later; why it took ASIC more than four months to take civil action over the trust; many of the senior executives at HIH were aware of the trust; Adler wrote several letters to key executives and directors informing them about the trust but those directors have not been called to give evidence; and ASIC only started proceedings against Williams, Adler and the former HIH financial director Dominic Fodera. Would you like to respond to that?

Mr Knott—I am very happy to. I think one can always be confident that, regardless of outcomes, someone will find a source of criticism. I have to say that I think it is very uninformed criticism and, if I may even say so, naive criticism. It is true that this trust was first brought to our attention on 22 December—virtually Christmas eve, for all intents and purposes. The investigation into the matters raised by the letter from the company commenced early in the new year and proceedings were commenced within four months. I think most investigatory agencies, whether they be public agencies or indeed private firms engaged in litigation, would say that that is a very short time frame in which to investigate a matter, marshal the evidence, obtain the legal advice and commence a prosecution—a prosecution which within a year has resulted in the orders which I recited just a few moments

ago. I think, frankly, that there is nothing in this article and that ASIC has every reason to effectively say that this matter was dealt with very expeditiously and very professionally.

Senator CONROY—What about the issue of other non-executive directors that were aware?

Mr Knott—Let me just be clear what this issue is. Which paragraph?

Senator CONROY—It is just in the terms that directors had been made aware of the trust—it implies for some considerable time before you were made aware of it—and yet you have not started proceedings against them. It is about the other directors who knew about it, basically.

Mr Knott—Yes, that is true. Part of the investigation focused on whether any person, including directors other than Adler, Williams and Fodera, had committed offences under the act which would be supported by available evidence. The conclusion of the investigation was that there was no such evidence, and there is nothing that we have seen in the course of the proceedings or in evidence led by any of the defendants or by any of the witnesses which would suggest to us that that judgment was wrong.

Senator CONROY—I wanted to tread on dangerous ground for a minute, but you would expect no less. Are you following closely the evidence at the royal commission given by Mr Malcolm Turnbull?

Mr Knott—I, like any member of the public, read the newspaper accounts of the evidence. It perhaps is a pertinent time for me just to remind you again, Senator, of my rather unusual circumstances as a result of advice from the Solicitor General some 12 months ago, which means that—

Senator CONROY—You are the perfect person to ask, because you are not involved in this litigation.

Mr Knott—I am not personally involved in the management of the HIH investigation. That means the matters that are before the royal commission as distinct from, for example, the PEE case.

Senator CONROY—Perfect. So you would be following Mr Turnbull's evidence?

Mr Knott—As an observer of the published information.

Senator CONROY—But still as the head of ASIC. ASIC have their own investigations taking place.

Mr Knott—We do, yes.

CHAIR—Nevertheless, Mr Knott, officers and Senator Conroy, I should caution you, perhaps unnecessarily but just for completeness, that it would be quite inappropriate for any reflection on Mr Turnbull to be made in relation to any matter that is either presently pending before the royal commission or concerning which ASIC might potentially be asked to examine evidence or both. Any such question I would rule out of order.

Senator CONROY—And which standing order are you making up today?

CHAIR—I am not making up any standing orders.

Senator CONROY—Could you point me to a standing order that says the operations of the Senate are impeded by legal action?

CHAIR—I have consulted Odgers and I have consulted the practice of the committee.

Senator CONROY—I was wondering if you could consult the Clerk of the Senate.

CHAIR—You ask your questions.

Senator CONROY—I am sorry—

CHAIR—You ask your questions. I have not ruled out any question yet. I have simply given some guidance to Mr Knott and the officers and to you.

Senator CONROY—Perhaps the secretariat might like to alert the Clerk of the Senate that there is likely to be an issue shortly and they might want to be in the room to give us advice.

CHAIR—If you wish Dr Dermody to do that, Senator, that is fine.

Senator CONROY—Thank you very much.

Mr Knott—Nevertheless, if I may, Chairman and Senator Conroy: I think certainly Senator Conroy would be aware from previous quite extensive dealings with this agency that it would not be our practice to discuss individuals or to reflect on individuals in the context of ongoing judicial or quasi-judicial proceedings, or indeed even investigations. I think the general tenor of your comments is appropriate, regardless of the issue of the standing orders. From this agency's point of view we would be very cautious before reflecting on reputations of individuals.

CHAIR—Mr Knott, I think what you have said in slightly different words is the substance and effect of what I had said. I am glad we all understand each other. Senator Conroy, proceed.

Senator CONROY—You might understand yourself, Senator Brandis, but you can only speak for yourself. I am doing my best to stay away from the royal commission, but I would not have thought that you are in a position to ignore evidence at the royal commission, particularly if you are looking at some of the similar matters. So are you aware of Mr Turnbull's role in advising Mr Adler in what I think is referred to as Project Firelight?

Mr Knott—I have no information or access to information in relation to that matter, other than what I have read in the press.

Senator CONROY—That is all I am asking. Are you aware of his role from what you have read in the newspapers?

Mr Knott—I have read press reports of Mr Turnbull's role.

Senator CONROY—You are aware of the prospectus circulated by FAI at the time of the takeover? Is 'prospectus' the right word?

Mr Knott—Senator, I think I might crave your indulgence for the reasons I have previously explained. You are aware that, because I happened to be a director of APRA for a short time, the Solicitor General opined that I was conflicted in being involved in the investigation into the collapse of HIH. I interpret the questions you are putting to me as connected with the collapse of HIH. I think in the circumstances I should follow the advice of the Solicitor General and ask that you respect that position.

Senator CONROY—Thanks, Mr Knott. Does that opinion cover your colleagues?

Mr Knott—No, not at all. ASIC is conducting an investigation into HIH. Ms Redfern may be able to address questions you have in relation to that matter.

Senator CONROY—You were aware of Mr Turnbull's role in Project Firelight?

Ms Redfern—Not personally.

Senator CONROY—I hope not.

Ms Redfern—Again, only from what I have read in detail, all I can say is that what ASIC has been doing as part of the process is considering a number of issues that are coming out of the royal commission in connection with its own investigations. To talk about or to dwell on those issues is really to get into the particulars about what our investigation is.

Senator CONROY—I actually do not know what your investigation is. My problem is that I just have to blunder around and hopefully you will let me know when I cross into one of your investigations. If I cross the line and bump into one of your ongoing investigations, you will let me know?

Ms Redfern—Senator Conroy, our position is that, for a whole number of very good reasons—one of which is focusing on particular individuals that we might have been investigating—it is our practice not to make comments about those matters when we are in the throes of an investigation. You can ask me questions about the investigation—

Senator CONROY—If I bump into an area you are investigating you will draw that to my attention and I will probably withdraw my question.

Mr Knott—Senator, I am sorry. I think the difficulty is this—

Senator WATSON—Point of order, Mr Chairman. If by chance Senator Conroy bumps into one of these issues which could be under investigation, that could be the signal to the outside community that that is the area of investigation. I ask you to rule on the point of order, Mr Chairman.

CHAIR—Do you wish to speak to the point of order, Senator Conroy?

Senator CONROY—I would caution you at this point on accepting Senator Watson's point of order.

CHAIR—Don't caution me. If you want to speak to the point of order, please do.

Senator CONROY—If Senator Watson's point of order was upheld, we would not in actual fact be able to ask ASIC any questions about any issue or anybody. Frankly, Senator Watson's position would close down this committee right now. How could we possibly know that perhaps Senator Brandis is not being investigated? I am sure you are not, but to actually say you cannot ask a question in case you bump into an ASIC investigation means that you cannot ask them any questions.

CHAIR—Senator Watson, do you want to reply?

Senator WATSON—The very point of your questioning on an issue to which it is likely that Ms Redfern may say 'this is the subject of investigation' would obviously highlight to the outside community that ASIC is working or potentially could be working on this area.

Senator CONROY—Fortunately, parliament is not bound by all of the legal rules, or in fact any of the legal rules, so we are entitled to pursue issues that are in the public domain and we are entitled to ask ASIC about issues in the public domain. I do not know whether Mr Turnbull, the federal treasurer of the Liberal Party, is under investigation by ASIC. Do you, Senator Watson?

CHAIR—You cannot ask questions of another senator. You can ask questions of me to clarify a ruling.

Senator CONROY—I accept your point of order—

CHAIR—Go on, Senator Conroy. I am listening carefully.

Senator CONROY—But realistically, if you were to uphold Senator Watson's ruling we actually could not proceed on any issue I want to raise, whether it is to do with HIIH or any other issue that could possibly impinge on any investigation they are doing, without me knowing in advance whether they are doing them. That ruling would create a farce of the Senate.

CHAIR—I do not want to go backwards and forwards between the two of you, but I will let Senator Watson have, as it were, a right of reply, it being his point of order. Then I will rule.

Senator CONROY—I did not know you actually got rights of reply on points of order.

CHAIR—As I understand the practice, Senator Conroy, there is at least theoretically an endless capacity for people to speak to points of order.

Senator CONROY—I did not know you got a couple of goes.

CHAIR—But you have had a reply.

Senator WATSON—Mr Knott might like to—

CHAIR—I do not want to hear Mr Knott on this because this is a matter for the Senate. Senator Watson?

Senator WATSON—You made a reference to the royal commission or any other matter. My point of order was taken in relation to a question that was asked in relation to the royal commission, not in relation to any other matter.

Senator CONROY—I have not asked a question about the royal commission. I specifically—

Senator WATSON—Surrounding the royal commission.

CHAIR—The substance and effect of the point of order, as I understood it, was an objection to a question about a named individual which might reveal whether or not that named individual was the subject of an investigation by ASIC. That is the point, if I can express it that way, that I understood you to be addressing, Senator Conroy. Have I expressed it the way you understood the point of order to be?

Senator CONROY—Senator Watson has just incorrectly described what happened.

CHAIR—I think Senator Watson has corrected himself—

Senator CONROY—I do not think he has.

CHAIR—by adopting my formulation of what I understood his point of order to be.

Senator CONROY—It is very good of you to interpret his point of order for him.

CHAIR—Well, I have to interpret the point of order because I have to rule on it. Therefore, I need to understand what it is. Senator Conroy, this is an important issue. I want to be careful. You heard the way I expressed the point of order. Regardless of any ruling, which I have not yet made, is that the point as you understood it and which you were addressing?

Senator CONROY—You will have to explain again what you think Senator Watson's point of order is.

CHAIR—Let me put it again as I understand it. As I understand it, Senator Watson's point of order was to object to a question which might reveal whether or not a named individual was the subject of current investigation by ASIC.

Senator WATSON—Or potential investigation.

Senator CONROY—I actually thought Senator Watson was worried about me asking a question about the royal commission, which is what he said in his right of reply.

CHAIR—Well, he has corrected himself. Is that, as you understand it, what we are debating, Senator Conroy?

Senator CONROY—I think you probably expressed more clearly than Senator Watson what he was thinking.

CHAIR—I think I understand what Senator Watson was saying. Given there was a little confusion about the way in which the point was expressed, I want to know whether you are satisfied that the point as I have expressed it is the point that you were addressing in arguing the point of order.

Senator CONROY—I think I probably understand the point of order as you have described it. Whether it was the point of order Senator Watson took, *Hansard* will prove.

CHAIR—That is the point of order—

Senator CONROY—Feel free to rule on whatever point of order you would like to rule on.

CHAIR—That is what Senator Watson wants me to rule on. Do you need to say anything else, Senator Conroy?

Senator CONROY—No.

CHAIR—As I understand the practice of this committee, not only in relation to this agency but also in relation to other agencies, investigations in relation to particular individuals are not ordinarily permitted to be the subject of questions. I am also mindful of resolution 11 of the resolutions agreed to by the Senate on 25 February 1988 governing the conduct of these proceedings, which provides:

Where a committee has reason to believe that evidence about to be given may reflect adversely on a person, the committee shall give consideration to hearing that evidence in private session.

Resolution 12 states:

Where a witness gives evidence reflecting adversely on a person and the committee is not satisfied that evidence is relevant to the committee's inquiry, the committee shall give consideration to expunging that evidence from the transcript of evidence, and to forbidding the publication of that evidence.

Both of those resolutions seem to me to support the view I have taken of the practice of committees not to permit, certainly in open session, inquiry into the existence or non-existence of investigations by regulatory agencies into the affairs of individuals or details of such investigations if they are current.

Finally, might I remind you, as I recited at the beginning of today's hearings, that the overall test of relevance as to the admissibility of evidence before this committee is governed by resolution 9 of the resolutions of the Senate, which is an obligation imposed on me to ensure that all questions put to witnesses are relevant to the committee's inquiry and that the information sought by those questions is necessary for the purpose of that inquiry. This inquiry has been defined as an inquiry into the particulars of proposed expenditure in respect

of the year ended 30 June 2003 for the portfolio area of Treasury, including agencies within the Treasury portfolio. I uphold Senator Watson's point of order.

Senator CONROY—Oh, you're a joke. You're a biased and partisan chair. You are an embarrassment to the Senate.

CHAIR—Order, Senator Conroy. I will invite you to put your next question, having regard to my ruling. I will not restrict you—

Senator CONROY—I am actually taking a point of order. Thank you. The comedy of embarrassment you have made for yourself in that ruling, Senator Brandis, if you go and check *Hansard*, is that Senator Watson in actual fact took a point of order before I had asked a question. So you have actually upheld a point of order—

CHAIR—That is why I have invited you to put your next question.

Senator CONROY—But you have ruled on a point of order taken by Senator Watson against something that did not actually happen.

CHAIR—I think what Senator Watson was perfectly entitled to do—indeed, it is commonplace—is take a point of order in relation to an apparent line of questioning.

Senator CONROY—Against a question he claimed I asked, which he repeated twice, which I didn't. And you have upheld his point of order.

CHAIR—I have given a ruling in the terms in which I have recited it.

Senator CONROY—You might have made it up as you went. Senator Watson took a point of order before I asked a question, and you have upheld—

CHAIR—Senator Conroy, a point of order does not—

Senator CONROY—You have upheld—

CHAIR—Senator Conroy, please let me speak. A point of order is not limited to a challenge to the admissibility of any particular question.

Senator CONROY—This is not a court of law.

CHAIR—It might also be—

Senator CONROY—You might miss the old hallowed pines in Queensland. This is not a court of law.

CHAIR—Let me finish, Senator Conroy. It might also be a point of order taken to a line of questioning or to an approach taken by a senator. In any event—

Senator CONROY—You just keep making it up as you go. This is a Liberal Party cover-up of Malcolm Turnbull.

CHAIR—Senator Conroy, I have made a ruling. Please proceed to ask your questions mindful of the terms of that ruling—also, I might say, mindful of the practice that Mr Knott, in my view quite properly, explained which his agency would adopt in relation to any such line of questioning.

Senator CONROY—As I have already asked for the Clerk of the Senate or the representative to come. I would also like to indicate I would like them to have a look at the *Hansard* on your point of order.

CHAIR—I can do that.

Senator CONROY—And give us an opinion on your point of order, given that you made up your own point of order that Senator Watson did not take.

CHAIR—Senator Conroy, we have got until 11 o'clock. Please proceed with your questions, mindful of the rulings I have made.

Senator CONROY—Has ASIC requested information from New York about Project Firelight?

Ms Redfern—I am not aware of the detail of that issue.

Senator CONROY—You are the deputy executive of enforcement?

Ms Redfern—I am the deputy executive director of enforcement, but I am not involved in every single investigative or enforcement issue on all matters around the commission.

Senator CONROY—It would seem to be relevant to any investigation into Project Firelight whether information was obtained from New York?

Ms Redfern—Senator Conroy, I have already said that I do not know the detail of whether there is or whether there is not an investigation into those issues.

Senator CONROY—That was more of a comment than a question.

Ms Redfern—My comment is that I—

Mr Knott—I am sorry to intervene again, but there was a point I was hoping to put to you a little earlier which I think goes to the nub of the problem we have here. You would be aware that ASIC's investigations are not conducted in public; that they are private investigations for a variety of good reasons. We have an unusual circumstance here in that there is a parallel investigation in public, and that, if you like, investigation is revealing a good deal of information and evidence. But the two processes are proceeding side by side. I think the expectation that we have to proceed on is that all evidence that has been given or may be given to the royal commission is of relevance to ASIC's investigations. It is quite possible that matters before the royal commission are already being investigated by ASIC, or may in the future be investigated by ASIC—or in fact, as a result of recommendations or findings of the royal commission, ASIC may be required to investigate. It seems to me that in those circumstances—very unusual circumstances; and without in any way wanting to be unhelpful to you—for us to comment in any way on evidence that has been given to the royal commission has the potential to frustrate either current investigations or future investigations. That is the problem that we find ourselves in.

Senator CONROY—You probably know more than me. I do not know whether you have asked the New York branch of Goldman Sachs for relevant documentation. I appreciate you know absolutely nothing about the case and you deliberately stayed away from it.

Mr Knott—I know this: if it was another case where I knew that we had requested information I would suggest to you that it would not be an appropriate answer for us to give. We would not normally, I think, be discussing here operational details of a current investigation with you. In my experience, you would not ask us questions about that; you would understand the sensitivity of it.

CHAIR—Indeed, Mr Knott, Senator Conroy is not at liberty to ask such questions, because I have ruled that such questions are out of order.

Senator CONROY—The chair can make it up as he goes as often as he likes, but he will not gag me to—

CHAIR—You can criticise the ruling, but that is the ruling—

Senator CONROY—He will not gag me to protect that spiv Turnbull under any circumstances—

CHAIR—Senator Conroy, that is the ruling.

Senator CONROY—You can keep flapping your gums as long as you want, Senator Brandis.

CHAIR—Senator Conroy, move on to your next question.

Senator CONROY—You can keep flapping your gums as much as you want. You do not have the power to gag—

CHAIR—I am the chair and I have the power to rule and I have done so.

Senator CONROY—And you can rule till the cows come home, Senator Brandis. You can flap your gums for hours. It will not stop me pursuing investigations or matters to do with the federal treasurer of the Liberal Party and part of that cover-up by you and the rest of the Liberal Party.

CHAIR—Senator Conroy, no questions in violation of my ruling will be permitted. It is that simple.

Senator CONROY—You can flap your gums as much as you want.

CHAIR—You can move on.

Senator CONROY—If you want to cover up for Turnbull, that is up to you.

CHAIR—Senator Conroy, you can make as many—

Senator CONROY—You will be judged in the court of public opinion.

CHAIR—Senator Conroy, you can make as many media grabs as you like to pursue a political agenda, but I am concerned with the due process of the committee and I will not—

Senator CONROY—You are concerned with gagging me and gagging the Senate—

CHAIR—I will not permit questions that are improper.

Senator CONROY—Because it is embarrassing to the Liberal Party to have another spiv as your federal treasurer.

CHAIR—Senator Conroy, move on to your next question, please.

Senator CONROY—I asked two nights ago about the cost to APRA of its involvement in the HIH royal commission and whether additional funding had been granted now that the royal commission had been extended past June. Have you received additional funding for that purpose?

Mr Knott—No, we have not received additional funding, but I think we are in a position to provide the information you are seeking in respect of current funding. Mr Iglesias would have that information.

Mr Iglesias—With the royal commission we receive \$4.6 million as part of funding towards and as part of the additional estimates. That is the funding we have received to date.

Senator CONROY—Was not most of that moved across to the actual royal commission? I know the government gave you extra funds to conduct an investigation but I thought it was then moved across?

Mr Knott—No, there have been two separate grants. The first was a grant of \$4.6 million for our dealings in relation to the royal commission. The separate was a special funding of \$5 million for our HIH investigation.

Senator CONROY—How do you obtain evidence from overseas jurisdictions?

Ms Redfern—There is a number of different ways. It is easier with some jurisdictions than others.

Senator CONROY—Say the US?

Ms Redfern—We have memoranda of understanding with various agencies, for instance, the US securities commission, the USSC.

Senator CONROY—So if you needed to collect documents from the New York office of Goldman Sachs you would be in a position to? There would be no lengthy legal process that you needed to go through?

Ms Redfern—I am not really sure. I have not personally been involved in having to collect documents from the US.

Senator CONROY—Mr Knott, do you have any experience in obtaining documents from overseas jurisdictions?

Mr Knott—Not directly, no. But I am aware, as Ms Redfern says, that the first issue is appropriate formal agreements between the regulators. The second then goes to the question of what the law requires in each jurisdiction. That can have an impact, for example, depending on the nature of the proceedings. In some jurisdictions it is more complicated to obtain information relating to criminal proceedings than it would be for civil proceedings, so it does alter from case to case and from country to country. It is fair to say that it is not infrequent for us to seek the cooperation of other jurisdictions, and in developed countries that is quite commonplace and becoming more so.

Senator CONROY—If in the course of your investigations you were seeking to retrieve emails that had been written over but which were sent between Australia and New York, would you be in a position to exercise your powers to retrieve them?

Ms Redfern—It is really the same issue that we were just talking about. What do you mean ‘written over’? Written between an office in the states and an office in Australia?

Senator CONROY—A New York office of, say, Goldman Sachs and an Australian office of, say, Goldman Sachs as examples?

Ms Redfern—Given your examples, I think what the chairman was saying is that it really does depend on a number of things. In relation to the memoranda of understanding, the purpose for which it is being used, I personally have not been involved in having to retrieve information through the states. I have done it with the UK. There are certain procedures. I am familiar with some of those. But I cannot provide any more detail about that.

Senator CONROY—Can I clarify something from some of your answers earlier? Are you familiar with any aspects of the investigation into matters relating to HIH? Are you working on it at all?

Ms Redfern—Am I working on it?

Senator CONROY—Yes.

Ms Redfern—I am familiar with it, but I am not working on it. There are certain aspects that I have worked on.

Senator CONROY—Do you get regular briefings as deputy executive director?

Ms Redfern—I would primarily be involved in a number of the litigation matters that have been before the courts. We have had no fewer than four matters before the courts in the last nine months.

Senator CONROY—Very successfully?

Ms Redfern—We have had a number of matters, including matters in relation to warrant proceedings and things like that. So I have primarily been working on or have intimate knowledge of those, but I am certainly familiar with the investigation.

Senator CONROY—Thank you. Let us move on to another favourite topic of mine. It is not John Elliott, Mr Knott, you will be relieved to know. I will not ask you how you are going in the water wheel case. I just eagerly await whatever you are going to do next on it. I wanted to ask some questions about your announcement last week that Mr John Starr, the administrator of National Textiles, had been disciplined by the CALDB. When was that matter referred to the CALDB?

Ms Redfern—I cannot tell you the precise date, but it would have been in the vicinity of 18 months ago.

Senator CONROY—When did you first start to investigate the conduct of Mr Starr?

Ms Redfern—As part of our investigation into national textiles and National Bartex, we were looking at a number of issues in relation to the deed of company arrangement. As a result of some of those issues we commenced investigating Mr Starr. Also, we had received a number of complaints in relation to some other companies, companies that we referred to in our media release of last week.

Senator CONROY—So you did not start investigating Mr Starr before the collapse of National Textiles? I saw there were a couple of different things he got pinged for.

Ms Redfern—I am not entirely clear on that. Perhaps I should take that on notice. I know that there were a couple of complaints and some issues that had arisen perhaps before then.

Senator CONROY—I was just trying to work out what event or events initiated your investigation, which would be those complaints you mentioned.

Ms Redfern—It is fair to say that, with administrators and liquidators and auditors, we may be looking at complaints over a period of time to form a view about whether there are systemic issues with the professional practice of that person. So it may not necessarily be one event. I might have to take that question on notice.

Senator CONROY—But you have a vague recollection that some of the complaints might have been before the collapse of national textiles?

Ms Redfern—I really cannot say. I know we had received a number of complaints in relation to some other companies—the companies referred to in the media release.

Senator CONROY—Unfortunately it is actually important, so I am keen to try to pin that down. If you did receive complaints about Mr Starr prior to the collapse of National Textiles, did you advise the Prime Minister, the Treasurer, the Minister for Financial Services or anyone else from their offices or departments of your investigations or concerns in relation to Mr Starr?

Ms Redfern—I cannot answer that question because I do not know whether we in fact did receive complaints that we were investigating prior to the appointment of Mr Starr as administrator.

Senator CONROY—Would it be normal if you were aware of concerns about a liquidator?

Ms Redfern—Would it be normal to what?

Senator CONROY—I am just trying to frame my question. I am just trying to avoid some of the earlier issues. I am just trying to be cautious because we would not want Senator Brandis to go red in the head again—it is not a pretty look.

Mr Knott—Perhaps I might help then. I think the position that we would confront from time to time is that professionals who are acting in that capacity but in respect of whom we have either not commenced investigations because we are not satisfied that the evidence would warrant that, or in respect of whom we have not proceeded sufficiently to form a view about whether disciplinary action was appropriate, would be engaged to conduct other administrations, receiverships or insolvencies. It would not be normal in those circumstances—and I would suggest to you it would not be reasonable in such circumstances—to be talking with third parties about unsubstantiated information.

Senator CONROY—This is a particularly unusual case, though, Mr Knott.

Mr Knott—In what respect, Senator?

Senator CONROY—In that the Prime Minister was personally involved, the Treasurer's office was personally involved. I think we did have some discussions about this previously. My recollection is that the Prime Minister went into parliament and called on people to accept the offer—a very unusual way to conduct an administration. The Prime Minister was personally involved for the obvious reason that his brother was the chair of the company and the Prime Minister went onto the floor of parliament, and I think even on radio, and urged people to accept the deed of arrangement. I think there were lengthy discussions taking place—

CHAIR—Senator Conroy, I caution you. I direct your attention to standing order 193(3) which prohibits you from making any imputation of an improper motive or making any personal reflection—

Senator CONROY—I haven't even got close to doing that.

CHAIR—on a member of another House.

Senator CONROY—I am getting there, but believe me, I haven't had a chance to get there yet.

CHAIR—I direct your attention to that standing order, Senator Conroy, and suggest that you be very careful.

Senator CONROY—I appreciate your concern because when you go bright red and that vein in your head starts standing out, it is not pretty.

CHAIR—Senator Conroy, you are talking about using parliamentary privilege to cast aspersions on individuals. As a matter of common decency, apart from proper order—

Senator CONROY—I have a point of order.

CHAIR—I suggest that you take caution. What is your point of order?

Senator CONROY—The chair has just seriously reflected on me and I seek a withdrawal.

CHAIR—Of what?

Senator CONROY—By imputing that I was slandering somebody. *Hansard* will bear that out so I would like you to withdraw your imputation that I was about to do something.

CHAIR—There was no such imputation; I was merely cautioning you in terms of standing order 193(3).

Senator CONROY—There is an imputation in your caution.

CHAIR—Not in my opinion.

Senator CONROY—So you are ruling against the point of order?

CHAIR—Yes.

Senator CONROY—Okay. I am just glad to see that we have got consistency taking place.

Mr Knott—Senator, I think I am able to answer your question.

Senator CONROY—I actually didn't think we were going anywhere near Senator Brandis's paranoia, but it is the Prime Minister he is protecting this time.

Mr Knott—I understand that the National Textiles case had a political dimension to it.

Senator CONROY—Direct contact did take place between the Treasurer's office, Minister Hockey's office and even the Prime Minister's office and ASIC, as an organisation, from my recollection. Does that ring a bell with you?

Mr Knott—I would have to consult the record on that. I am not clear about that. What I am clear about is that the decision to commence the investigation was ASIC's. The process of the investigation was entirely consistent with ASIC's normal process. The investigation was not influenced by any external factor, and the way that we dealt with Mr Starr, which I think is your question, did not differ in any respect from our normal procedure.

Senator CONROY—So that would imply, Mr Knott, that at no stage were the Prime Minister, the Treasurer, the minister for financial services or anyone from their offices or departments advised of concerns that ASIC may have had about Mr Starr. I know that it is not normal for you to ring up the PM and have a chat about any ongoing investigation. Would that be a fair way of describing it? It would not be normal practice. What you said was that this particular investigation was conducted normally.

Mr Knott—It was.

Senator CONROY—Just to satisfy my morbid curiosity, if you could take on notice to check what communications were, if any, taking place. I have a vague recollection that there was definitely some contact. The Prime Minister was being briefed, whether it was by the Treasurer and the Treasurer was getting information. I have actually spoken on this in parliament.

Mr Knott—I certainly will check that and inform you. I do not want to rely entirely on my memory, but it is my memory, subject to verification, that there was a question received from the Treasurer's office as to whether we intended to investigate this matter and—

Senator CONROY—Yes. That would constitute contact.

Mr Knott—we were able to advise the Treasurer that we had already commenced an investigation in the matter. It is also my recollection that, absent that contact, there was no other contact in relation to the investigation either before or after.

Senator CONROY—My recollection is that the Treasurer is the one who revealed on the floor of parliament that you were actually conducting an investigation. Did you note that—that the Treasurer revealed an ASIC investigation on the floor of parliament? Senator Brandis, isn't he lucky that you weren't in the chair that day.

CHAIR—I am sorry, Senator Conroy, I am just here to listen to you ask questions of the witnesses.

Senator CONROY—How disappointing. I am sure the Treasurer, Mr Costello, would have enjoyed your rulings if you had been in the chair at that time.

CHAIR—Senator Conroy, you have got two hours, so get on with it.

Senator CONROY—Thank you for your courteous ruling. Can you recall the circumstances in which Mr Starr was appointed as the administrator of National Textiles? Was he appointed by the directors?

Mr Knott—I would have to refer to Ms Redfern.

Ms Redfern—Yes, it was a voluntary administration. That is the way—

Senator CONROY—That is what happens, yes.

Ms Redfern—Yes, that is what happens.

Senator CONROY—What were your specific complaints in relation to Mr Starr's handling of National Textiles?

Ms Redfern—National Textiles only? Not the other companies that we were concerned about?

Senator CONROY—If Bart was related—

Ms Redfern—No.

Senator CONROY—Bartex is the company of one of the other directors.

Ms Redfern—One of the issues that emerged quite early in the piece that we were involved with was the issue in relation to Mr Starr's involvement with Mr Bart's brother, which Mr Starr disclosed to the creditors during one of the early creditors' meetings. That was one issue—

Senator CONROY—Please keep going.

Ms Redfern—Certainly not the subject of our investigation. I am not clear on your question. You are wanting me to go through our concerns generally that led to the outcome?

Senator CONROY—Generally, yes, please, but with specific reference to National Textiles.

Ms Redfern—To talk at a general level, because this is a professional body—the CALDB, where we refer matters in relation to professional conduct—one of the key matters of concern that we had in relation to a number of the companies in the administrations that Mr Starr had undertaken was in relation to his disclosure to creditors. Part of the voluntary administration phase of insolvencies is that somebody goes in, somebody has a look at the issues, looks at

recoveries, looks at whether the company can trade out, and then reports to the creditors on the various options that they have.

Our general concern was that we do not believe that Mr Starr's reporting to the creditors, in a number of instances, not only in relation to National Textiles but in relation to a number of companies, was adequate. We considered this to be an important issue. There were no fewer than 11 companies where these issues were raised and we believe that this was a very important part of the administration process so that creditors could be fully informed about making their decisions.

Senator CONROY—In the report on National Textiles, Mr Starr states:

The scope of my investigation, however, has been limited by time constraints imposed by the reporting timetable of the law. Information contained and commented on in this report has been provided from the company's books and records, advice from the company officers and employees in communication with third parties. The investigation by a voluntary administrator is not tantamount to that of a liquidator and creditors should take this into consideration when considering the information presented herein. I have not obtained verification or confirmation of this information in all instances.

Is that form of comment common in a report to creditors by a voluntary administrator?

Ms Redfern—There are certainly time constraints in voluntary administrations. In many cases, administrators apply for extensions if they feel that they have not had sufficient time to investigate and report to the creditors. Now that you have read this, I do recall that from this particular report.

Senator CONROY—Was this of concern to you?

Ms Redfern—Yes, I think in this particular case it is not so much the qualification issues—and it is important for the administrator to make those qualification issues where they apply—but our concern was the balance of the report, the content of it, the issues raised or not raised.

Senator CONROY—I am probably going to come to that in a minute. You are ahead of me there, but please keep going.

Ms Redfern—Those are the sorts of issues that we were concerned about.

Senator CONROY—Did Mr Starr notify you of the offences that he noted in his report to creditors?

Ms Redfern—We certainly got a copy of the report. I just cannot recall. That was one of our issues. That was one of our concerns.

Senator CONROY—Perhaps it was one of the issues. You have got a copy.

Ms Redfern—The issues that we were looking at at the time were in relation to the deed.

Senator CONROY—The question is: did he give you the copy or did he point it out to you, or did you just happen to get it yourself?

Ms Redfern—One of the things that we were looking at in great detail at the time was the issue in relation to the deed of company arrangement and whether we would take any action in relation to that. So we were very familiar with the issues at the time and ourselves took a very detailed and extensive investigation.

Senator CONROY—Did Mr Starr provide any information to you in relation to your investigation of National Textiles?

Ms Redfern—Not that I can recall. In fact, we were far more advanced in many respects in our own investigation. In a fairly short period of time, we had conducted a number of examinations and very detailed, extensive investigation.

Senator CONROY—I want to draw to your attention a Federal Court matter that involved Mr Starr. I am not sure, actually, if you are familiar with it. It is the case re Bruce Raymond Woolford and John William O'Brien where the Federal Court said of Mr Starr:

I cannot, however, part with the matter without recording that Mr Starr was a most unsatisfactory witness. He was, in my view, less than frank in many of his answers. At times, he bordered on the obtuse. I am satisfied that, had he wished to do so, he could have thrown a good deal more light on the events which occurred. The comment made by senior counsel for Mr O'Brien that his performance as a witness gave the appearance of a pretended amnesia was quite apt. It may be doubted whether, if the facts surrounding his conduct in relation to the part 10 arrangement concerning Mr Broad had been known at the time, he would not have been regarded as a person suitable to be registered as a trustee under the act.

Are you familiar with that case?

CHAIR—Ms Redfern and other officers, for a reason which will become apparent in about a minute, I am going to adjourn the committee for one minute. Please don't answer that question. Senator Conroy, can I speak to you informally? There is something I need to tell you.

Proceedings suspended from 9.03 p.m. to 9.08 p.m.

CHAIR—I call the committee to order. Can I note for the record that Senator Schacht has arrived and is participating now in the hearing. May I explain to witnesses the reason for the interruption. Senator Conroy is not a full member of this committee; he is a participating member. Senator Watson and I and Senator Schacht are full members of the committee. Under the Senate standing orders, for this committee to be quorate it requires the presence of both an opposition and a government senator. When the committee convened this morning, Senator Collins, the deputy chair of the committee, who is an opposition senator, was here, as of course was I. At the commencement of the hearings today the committee was quorate. Subsequently, during the course of the day opposition senators have withdrawn and, as has been the case since the resumption after the dinner break, the only opposition senator here has been Senator Conroy, who is not a full member of the committee.

On one view of the standing orders, the committee is therefore not quorate, although it has now become quorate by reason of the arrival of Senator Schacht. If the committee is inquorate, nothing said here attracts parliamentary privilege. Now I do not consider that anything said by any of the witnesses, at least since the dinner adjournment, is a statement of a defamatory character which would require the protection of parliamentary privilege. But given the sensitivity of these matters, and before Senator Conroy proceeds with his questions and subject to my earlier ruling as to relevancy and current investigations, it seemed to me, for your protection, Ms Redfern and gentlemen, that we should be quite certain that these proceedings are protected by parliamentary privilege; hence Senator Schacht's presence for the rest of the evening I hope. Senator Conroy.

Senator SCHACHT—Mr Chairman, I do not want to delay it, but Senator Conroy has quietly briefed me about a ruling that the clerks have apparently given about this, which I was unaware of. I always took it that, based on the practice in the chamber, the chamber always has a quorum unless someone calls, and then you have a count to find out—

Senator CONROY—But someone needs to be a member of the chamber.

CHAIR—Go on, Senator Schacht.

Senator SCHACHT—Someone calls a quorum, you have a count and if there are not 18 or 19 senators there you get four minutes or whatever it is to turn up. Pardon my ignorance about the arcane rules of the Senate, but why wouldn't the same operate in a committee? If a member of the committee or someone called as a member of the committee or even a participating member pointed out to you that they thought that there was not a quorum present, you would then count and say, 'Yes, there's not a quorum present,' and then suspend the meeting until the quorum turns up. If it is the same practice for the Senate, that would mean that the Senate would never have a quorum other than for question time. Why I raise this—I am not asking you to rule on it; I will have to unfortunately accept it here tonight—is that I would like an explanation from the President of why the practice for a Senate committee is different from the practice of the chamber.

CHAIR—I understand your point, Senator Schacht. The simple answer is that I am not sure what the answer to it is. However, I am advised by Senator Watson, who is I think the second most experienced senator in the Senate, and also by the Clerk, that there is a sufficient doubt about whether what you say is correct. But I am not prepared to expose these witnesses and indeed my friend Senator Conroy to the risk that anything they say may not be protected by parliamentary privilege.

Senator SCHACHT—I appreciate that, but can I ask you to refer my query to the President. Obviously she will seek the advice of the clerks about that ruling. Secondly, if there is a doubt, why can't the Senate fix the doubt by carrying a resolution to make it clear? We can amend the standing orders any time we like.

CHAIR—Senator Schacht, I can now answer with a little more certainty the question that you put, and that is that my caution was correct. My attention has been directed to standing order 29(2), which reads:

When a quorum is not present at a meeting of a committee the chairman shall suspend the proceedings of the committee until a quorum is present, or adjourn the committee.

It appears that the practice in the chamber is not the practice of committees by reason of that standing order. Therefore, anything that has been said in this committee while it has been inquorate is in fact not protected by parliamentary privilege.

Senator SCHACHT—I understand that and I accept your ruling in view of that standing order. But it does seem to me a bit odd that we have a specific standing order for a committee saying that; I have to say that that means that large sections of the estimates hearings for this last two weeks that I have observed have not had a quorum, and the chairman did not have it brought to his attention. The point I raise here is in the chamber the President, the Deputy President or the Acting President only calls a quorum when it is brought to their attention. They can look around the Senate chamber and see that there is no quorum present, but they only respond to a quorum call if some other senator calls it. My view would be that if the practice is good enough for the Senate chamber, then, if there is a query about the quorum here, it should be called by another senator drawing it to your attention and then you suspend it. That means that I think we have to change that resolution if the Senate has the same mind.

I would just ask that the matter that I had raised be referred to the President. I suspect it would be left to further discussion if people want to change that particular standing order. There may be good reasons not to. It just seems a bit odd that we have one rule for the chamber and a different one for the committee.

CHAIR—In this instance you are quite right, but standing order 29(2) does seem to be unambiguous in its terms and there does seem to be an anomaly. It is true, as you say, that not merely this committee but I think most estimates committees quite often proceed informally in an inquorate fashion, but given the nature of the lines of inquiry being pursued by Senator Conroy and the necessity to protect the witnesses as well as the inquirer, it seems to me that this is an occasion when the standing orders ought to be strictly construed.

Senator SCHACHT—There is one other query that I would raise to be referred to the President. I understand that it may be that the clerks and assistant clerks have advised the secretaries of Senate committees that if they believe there is no quorum present they should draw it to the chair's attention in the committee. I think that is inappropriate. I think only the members of the committee who are senators can call an issue of a quorum. I do not accept that that is the case. I am not in any way criticising the secretary of this committee or any other.

Senator CONROY—I think it was Senator Watson who did it this time.

Senator SCHACHT—That is fine. But I understand that may be the case. I think that is another matter the President should seek discussion on, with not only the Clerk but other senators, because I think that puts a responsibility in terms of advice, say, from the Clerk to the secretary of this committee, saying, 'I think this is inquorate, bring it to the attention of the Chairman.' They do not do that in the Senate chamber.

CHAIR—Senator Schacht, all I can say is that your observations are on the record. They are noted and, as you request, I will cause the matter to be referred to the President. I have been listening to the evidence carefully since we resumed at 8 o'clock. I do not think that anything said by any of the witnesses while the committee was inquorate could expose them to a liability in the event that the proceedings were not covered by parliamentary privilege. Senator Conroy?

Mr Knott—I wonder if I may be able to just make a brief comment on the record?

CHAIR—Yes.

Mr Knott—I wish to record my very serious concern that the chairman of this commission and senior officers may have been exposed to questioning by this committee in the absence of parliamentary privilege. That is completely contrary to the advice that is given to us before we appear. It is completely contrary to the spirit in which we come to give evidence. If it transpires that we have not been covered by parliamentary privilege, it raises very serious issues for the future. I simply record that matter to you, Mr Chairman. It is by no means intended to be a reflection on your ruling, but if, as you say, standing order 29(2) requires the proceedings of this committee to have been suspended in the absence of a quorum, I think that is what should have happened. I can tell you that I am very uneasy about some of the discussions that have taken place.

CHAIR—Mr Knott, your comment is noted.

Senator CONROY—I had read to you a judgment in a Federal Court matter relating to Mr Starr which casts doubts on his capacity at that stage as a trustee, which is a very similar type of responsibility to that of an administrator. Were you aware of that?

Ms Redfern—I am not aware of that judgment.

Senator CONROY—You issued a press release on 8 August when you concluded your investigation into the collapse of National Textiles. Are you still of the view that there is nothing to warrant action against any director?

Mr Knott—I think the press release was issued under my name. I am quite happy to respond in the affirmative. There is absolutely nothing that comes out of our disciplinary proceedings against Mr Starr that in any way impacts on the results of our investigation into the collapse of National Textiles. The investigation in that case was directed primarily to the question of whether the directors of that company had continued to trade while the company was insolvent. It was a very detailed investigation. It was very thorough. It was based on our own collection and analysis of evidence. Nothing that Mr Starr did or did not do has any bearing whatever on the outcome of that investigation.

Senator CONROY—How generous of you. Now I want to go to some good news. I notice in the budget that you finally got some additional funding. I understand that was the result of an independent pricing review. What was the independent pricing review conducted on?

Mr Knott—I will give a brief response, if I may, and defer to Mr Iglesias. The pricing review mechanism is the internal government process by which the Department of Finance and Administration inquires into the operation and budget of agencies and departments. It involves benchmarking efficiencies of agencies and departments against other bodies in an attempt to determine whether the affairs and mandate of those bodies are being carried out efficiently. My understanding is that over the years pricing reviews have resulted in recommendations to government that budgets be both increased or decreased according to the outcome of the review. But I am able to ask Mr Iglesias to describe in more detail the process.

Senator CONROY—It is a winner, so you want to keep doing it.

Mr Iglesias—The process seeks to price the outputs of the agency and, as the chairman has mentioned already, in so doing they cost the outputs of the agency and then benchmark those costs against both public sector and private sector agencies, determining therefore whether the agency is delivering those outputs at a reasonable price comparable to the market or not.

Senator CONROY—Can you confirm that you were seriously underfunded and had insufficient funds to do the job, as Mr Cameron said a couple of years ago?

Mr Iglesias—It confirmed that, particularly in terms of our infrastructure support and the work that we were doing, the back office work, if you like, we were certainly competitive with public sector and private sector. Our proposal, however, was not necessarily aimed at indicating or suggesting that we were underfunded; it was merely putting forward a proposal suggesting that we needed an addition to our base funding in order to implement the Financial Services (Reform) Act and also to increase our enforcement activity.

Senator CONROY—When was the review completed?

Mr Iglesias—The review was completed about November 2001. The final report was presented to the Department of Finance and Administration in December. We then went again in January this year to the department of finance to follow up with some further information. It was then considered by the Expenditure Review Committee.

Senator CONROY—So in 2002-03 you appear to have got \$19.3 million in additional funding?

Mr Iglesias—That is correct.

Senator CONROY—\$11.9 million was allocated to you as FSRA?

Mr Iglesias—To FSRA, \$10.8 million plus \$1.13 for FSR enforcement.

Senator CONROY—That is a substantial amount, thankfully. How has the workload associated with FSRA been? Is it more significant than anticipated at the beginning? It is such a huge change. I am sure it is an enormous workload?

Mr Knott—I will do my best to answer for Mr Johnston in his absence. But, yes, I think the build-up to 11 March for the introduction of the act where a lot of preparation was done and money started to be spent has been followed by the commencement of the licensing process. The hiring of additional people to come on board, which we think will peak towards the end of this calendar year and the first half of 2003, is all proceeding fairly much as we expected.

Senator CONROY—So it has not blown out?

Mr Knott—No, it has not blown out. In terms of the experience we are having with licence applications, they are disappointing us in the sense of not being as advanced as we hoped they would be. So it has meant that not as many licences have issued as we would have hoped. But in terms of the workload I think it is very much as expected.

Senator CONROY—You received \$7.4 million for general enforcement activity. How will that money be spent?

Mr Iglesias—Yes, that is correct. There are several elements to that amount of money. It is being described as \$7.4 million to increase our general enforcement capacity, and that is correct, but it will also go towards increasing our capability in terms of responding to complaints and also to extend our Internet enforcement or electronic enforcement as well.

Senator CONROY—Other than the FSRA money, is any of the remaining money tied to one specific project? I appreciate your last answer, but is any of it tied?

Mr Iglesias—Not tied in the sense that if we do not expend funds on that particular initiative we have to hand those funds back to the government, no.

Senator CONROY—But it is tied to specific initiatives?

Mr Iglesias—To the extent that we sought the funding to support our implementation of the FSR Act, for instance.

Senator CONROY—I think you mentioned, though, that you have got a specific amount for FSR enforcement?

Mr Iglesias—Yes, that is right. The funding for FSR enforcement was conditional upon us establishing that we had achieved results in the enforcement of the FSR Act. The future funding for that is provisional on that outcome.

Senator CONROY—You closed the small business unit, from recollection, a year or two ago because you had to rationalise in some areas. Is that likely to be re-established? That is an enforcement arm. Is that one of the areas envisaged in this small business liquidation area? I know it has been an area of significant complaint, because you lost the resources a few years ago. Is that one of the areas you are looking at?

Mr Knott—The answer is that it is unlikely we would re-form the unit as a separate unit, but functionally certainly this additional funding will help us to restore some of the activity previously curtailed in the small business area and in the area of assisting company liquidators to pursue their responsibilities.

Senator CONROY—In the four years, how much in additional resources did you get and was any of that earmarked or tied?

Mr Iglesias—Sorry? I do not understand what you mean by resources. Do you mean in terms of dollars?

Senator CONROY—You are getting more money in the out years.

Mr Iglesias—The funding that we have received in the out years, again, will be for us to continue our ongoing administration of the Financial Services Reform Act and also to continue our increased general enforcement capability on an ongoing basis. It is not tied in the sense that, if we do not expend the funds on a particular proposal or bid, we have to hand it back. So it is not of that nature at all.

Senator SCHACHT—Mr Knott, now that I have been conscripted here to protect your privilege, from being sued, I will ask you a couple of questions. It relates back to earlier today. I think that you were sitting in the audience when I finally—

Senator WATSON—Senator Schacht, it is not only the witnesses.

Senator SCHACHT—I know, of course. My colleagues would never, ever do anything that would be defamatory. Mr Knott, I know you were in the audience when I asked a question about a particular area of disclosure of information on superannuation annual reports back to the individual customer. I had finally hit home that I had got to the right people rather than pestering you previously, or APRA. But one thing that I do want to ask you is: although the parliamentary secretary said that the government would like to spend a couple of years bedding down the new regulations, have you had any complaints through ASIC from people—variations of my complaint—that they cannot work out what the information is on the sheet about what their fees were and so on?

Mr Knott—I cannot answer that question specifically. There was a discussion in your absence, incidentally, earlier about this whole matter. But in relation to specific complaints, I can take it on notice, if you wish me to. Can I just say, though, that it would surprise me if we had not had some complaints in this area.

Senator SCHACHT—I can give you one complaint. Take it on board that I have got a complaint now. So there is one.

Mr Knott—And I think that it is an old complaint, because I think that I have heard it before.

Senator SCHACHT—Yes, it is a continuing complaint. I know that you will say that you spoke to the Treasury people; it is they who set the policy in this area and you just enforce what it is. But as a statutory organisation, you are not incapable of having views and expressing views, if you wanted to, as a statutory organisation, to your minister—in this case the Treasurer. Do you believe, with respect to the issue that I raised—this very narrow issue, compared with the broader issue that Senator Sherry raised—that that is a reasonable piece of information to provide to consumers in terms of dollars and cents?

Mr Knott—I think the best way to answer that is that we have issued policy quite recently in which we have indicated a preference for dollar disclosure. I think our preference for that disclosure is well known by Treasury. The process of consultation was a very long and involved one where a lot of different views were expressed. The current position, as you heard earlier today, was the position finally reached by the government with the advice of Treasury. But I also made the point earlier today, just for your information, that we will be attempting to facilitate discussions between the various industry sectors—consumers and the like—over the next year or so, taking the minister's point that he wants the year or two for this to bed down

to see whether during the course of that timeframe we can identify more of a consensus position.

Senator SCHACHT—I do not think that you will get a consensus, because I think that there is a vested interest in the industry who, for some reason, are paranoid about this, from what I have heard when I have raised it in other discussions. It is as though you are giving the secrets of the crown jewels away, or whatever. But I think that it is consumer information. One thing that I want to ask you is this: you heard today the Treasury people say—and I have heard this argument, too—that it is very difficult for the fund to break down the cost into a dollar and cents amount, because each day it is variable et cetera, about which I expressed some incredulity. Why could you not get a software package together and program your computer to do it? Do you think that, in view of your experience where you have to deal with companies, prospectuses and memorandums of association, it is possible to draw up a computer program, a software program, in your experience? You probably have more experience of this in other areas about making information available in things like prospectuses and memorandums of association et cetera to investors.

Mr Knott—I am grateful for your good opinion of my experience; nevertheless, I do—

Senator SCHACHT—If you do not have the experience, then I am really worried, because you are the one who is at the forefront of it every day.

Mr Knott—We are at the forefront of enforcing disclosure requirements of the law. I think that this goes to the very heart of the process that I have tried to describe. We need to have a much more detailed dialogue than we have had with industry groups about just what is their problem, what is the difficulty, why can they not do this, what is the objection. That is a process. We will be acting as facilitators. We have no mandate in the end to dictate an outcome, but we will take a facilitative role and, hopefully, they will come along for the discussions.

Senator SCHACHT—Good. I have a couple of quick questions on a different area. Again, one's own experience is always the best example—and this is not a nasty experience that I have had. When I made an investment in a vineyard in South Australia, the information paper—it was not actually a prospectus—was detailed; you read it carefully and got advice. You could make a judgment if you were serious about it. Since some of those things went out—not the one that I am in, thank goodness—the tax office knocked them back, they had withdrawn the tax concession et cetera. Did they ever have discussions with you, or did you ever have discussions with them when someone comes along with a memorandum—

Mr Knott—Information memorandum.

Senator SCHACHT—to say, 'We suggest you go and see the tax office to make sure that this is correct,' or, 'We are a bit nervous about this because you might be misleading investors,' or do you just say, 'You put it out and you take the risk and the law might cut a finger off or the tax office will get you, or we might come and get you for a misleading information memorandum.'

Mr Knott—I am going to ask Mr Rodgers to assist with this answer, but I want to give you some information about what we have been doing in the last 18 months. We have been concerned about potential misrepresentation in prospectuses generally, but in particular in some of the agricultural type schemes that you described. We introduced a policy about 18 months ago, I think it was, which tightened up the requirements for promoters making future

forecasts of profitability—the investment returns. That has led to a quite significant tightening on the issuers.

Senator SCHACHT—That has reduced the number of—

Mr Knott—It has reduced the number of issues, but, more importantly perhaps, it significantly increased the number of issues that have received stop orders from us in order to enable better disclosure to be included in the prospectus. In many cases then the issues have proceeded but with information that better informs the investor. That is the type of work we have been undertaking. We did have a discussion when Mr Johnston was here about some specific aspects of highly tax driven schemes, but I do not think they are at the heart of what you are asking about.

Senator SCHACHT—No. What I am looking at is the range of it where someone invests. There are tax deductions, and that is why people invest. It goes from 47c in the dollar. They put it all in the information memorandum—that, over the first three years, you get all of this as a deduction et cetera. There are some scallywags out there who are crooks, let us be honest about that. They will be caught. Going back a couple of years, did you at any stage get to the stage where you thought, ‘We’re being flooded with these demands for information memorandums. Something’s going on. We’d better have a talk to the tax office to make sure they understand someone’s trying to open up something here that’s going to cost the revenue’?

Mr Knott—We have done a number of things. I will ask Mr Rodgers to finish the answer.

Mr Rodgers—I have a couple of comments to add to what Mr Knott has said. We have run campaigns for many years coming up to tax time suggesting that people need to be very careful in choosing what is marketed to them as tax-effective investments. We have at the same time—and I think as Mr Johnston referred to earlier today—maintained an increasingly close dialogue with the tax office over these kinds of schemes. I might add one final thing: if you have invested on the basis of an information memorandum rather than a prospectus, you are almost certainly not investing in a scheme that is regulated by the Corporations Act, I would suggest, because it is probably so small that it is not caught as a managed investment. I might personally give you some advice on another occasion about how wise that might be.

Senator SCHACHT—I might give you a call about that. Thank you very much. Can I ask you to take on notice, Mr Knott, the figures in the last, say, four years of how many memorandums of information you have knocked back or sent back for further—

Senator CONROY—An increasing number, I can assure you.

Mr Knott—That would be prospectuses and, yes, we can provide that.

Senator SCHACHT—In relation to memorandums, do you have any control over those? Do you have any regulatory function?

Mr Rodgers—The term is most commonly used by people who are making an offering which does not require a prospectus, so it is not a regulated offering in that sense.

Senator SCHACHT—I see.

Mr Rodgers—I can, however, tell you that I think last year’s annual report showed that we issued 81 stop orders during the year—

Senator SCHACHT—On prospectuses?

Mr Rodgers—On prospectuses or other regulated offer documents. The count for this year, as I understand it, at the end of May was 80-something.

Senator SCHACHT—Already?

Mr Rodgers—And there have been a rash of stop orders since that number.

Senator SCHACHT—Thanks.

Senator CONROY—I want to talk about the ASX Singapore link and some related matters. I want to follow up on one item not completed in the inquiry in the framework for Australia's stock markets. It has been agreed that the arrangements between ASIC and the ASX for handling conflict and perceptions of conflict in relation to the supervision of ASX International Services, AIS, as a participating organisation of ASX would be trialed for three months and be reviewed not later than 30 April 2002. Have those arrangements now been reviewed?

Mr Rodgers—We have not conducted a formal review, although we have kept that issue under close observation. We are in fact directly supervising the ASX licensed entity that conducts that business as part of the arrangement. It is a licensee and we are the issuer of the licence. I might point out that the degree of traffic on that link is relatively small. I think that there has been a preponderance of incoming trades rather than outgoing trades. I might need to check this, but I think the figure is only 170 outbound trades, amounting to quite a small amount of money compared to some significant trades coming in from Singapore. While we are keeping a watch on that issue, it is not claiming particular regulatory attention at this point.

Senator CONROY—Have many changes been made to the arrangements as a result of the investigation or review?

Mr Rodgers—No, I think there have been no changes of any substance to the arrangements we described to a different committee earlier.

Senator CONROY—I read a newspaper article last month saying that the ASX is poised to announce links with a major European stock exchange. I do not think the minister was involved in this particular announcement this time.

Mr Rodgers—I am aware of the media report that you are referring to. It purports to be a quote from a speech given by Mr Humphrey which was the subject of subsequent press comment.

Senator CONROY—Did you conduct an investigation into the possible release of information to the market?

Mr Rodgers—As I recall, those comments were made at a speech given at the weekend. We were in discussions with ASX before the market opened on the Monday morning. I should say that the ASX view was that there was no price-sensitive information in the remarks that Mr Humphrey made at that—

Senator CONROY—In the disclosure requirements about negotiations?

Mr Rodgers—As I said, the ASX's view was that there was no price-sensitive information in anything Mr Humphrey had said over the weekend. However, we had encouraged and ASX had clarified that matter by a market announcement which was made before the market opened. Indeed, part of our role, you might recall, in this area is to be the listing adviser on

ASX. We had required ASX to go into a trading halt while the market digested the information which ASX made available to the market. So at no stage was there trading—

Senator CONROY—I appreciate that. Is there any requirement under continuous disclosure laws to reveal when negotiations commence?

Mr Rodgers—There is a requirement to make a disclosure to the market under listing rule 3.1 if a listed entity is in possession of price-sensitive information. You may recall that there is an exception contemplated by the listing rule if a number of criteria are met. This, I suggest—

Senator CONROY—So the ASX retreated to one of the carve-outs in the continuous disclosure laws?

Mr Rodgers—No. It maintained that there was no price-sensitive information rather than claim the benefit of any of the exceptions to listing rule 3.1.

Mr Knott—I might intervene and say that it is clear from our action that we were unhappy—

Senator CONROY—You were absolutely on top of it. It is a question of a bit of a mix-up there at the other end. Is that linkage likely to be on the same terms as the Singapore-ASX linkage?

Mr Rodgers—We have not been formally approached by ASX with any particular proposition, but we will shortly be discussing in more detail those proposals.

Senator CONROY—I also recall that the Singapore exchange and the ASX had to change the terms of their business rules. Is the same contemplated here and do any new issues arise?

Mr Rodgers—It is not a question I am in a position to answer at this stage.

Senator CONROY—Recently it was also announced that Australian fund managers would be given streamlined access to the Hong Kong market. What was ASIC's involvement in that outcome? I think you were either in the room or in the next room when I asked Treasury this earlier. They suggested that you were perhaps, as the lead agent in these discussions, the more appropriate people to answer the question, but I will repeat it to you: do Australian investors have the same protections when they are investing in the Hong Kong market as they do in the Australian market?

Mr Knott—I think there was some confusion in that earlier discussion in this sense: the capacity for Australian investors to invest into products into Hong Kong through this mechanism has been in place for many years. What happened a week or so ago is that the reciprocal arrangements can be put in place that would enable Hong Kong investors to invest into Australia.

Mr Rodgers—I might just clarify that. It would enable Australian fund managers to offer their products in Hong Kong on a basis that really is reciprocal to the longstanding arrangement that Knott described.

Mr Knott—That is a better way to explain it.

Senator CONROY—Can I come back to this ongoing arrangement that has been around for a few years? Are Australian investors as protected when investing in Hong Kong as they are here in Australia?

Mr Rodgers—This was an ASIC decision taken in the early nineties. It is embodied in a policy statement which was itself the result of public hearings held by ASIC. Our policy is

premised on the basis that we will grant some exemptions from the Australian laws as they apply to what are now called managed investments on the basis that we can be confident that their home jurisdiction and the combination of the conditions that we apply to that relief will not result in any lessening of the protection available to Australian investors. It is key plank of that policy which I think has been in place since 1994.

Senator CONROY—I want to congratulate you on your decision to conduct a formal surveillance program of brokers and analysts over the next few months. Can you briefly outline what you are proposing? What is the formal state of this program?

Mr Knott—Again, Mr Rodgers may want to talk to some of the detail, which I think we can safely discuss; I think it is known to the industry. I would like to preface the answer by saying that obviously, with the degree of movement in this area overseas and the fact that so much of the industry is owned overseas, we have an expectation that rules recently applied to Merrill Lynch in New York are likely to become of wide usage. We think it is probable that US-based firms will apply those rules internationally. While we will be pursuing the work that you mention, we also think it is very sensible to be informed by the developments offshore and see how they are extended to Australia.

Senator CONROY—You would be aware, though, that there is heavy criticism of the new rules, and particularly of the SEC and Mr Pitt. Many regard that the SEC has lost its way. I am not asking you to comment on that specifically, but the issue of whether or not it is just because that is as far as the US market is prepared to go is a live issue in this instance. I would be disappointed if you were saying, ‘Look, just because the big firms over in the US are going to make the same things happen here is not necessarily the most positive outcome that we could possibly achieve.’ I am sure you are familiar with what is mounting criticism of the SEC in the US.

Mr Knott—Dealing with that point first, I am a little puzzled by that because the rules that have been introduced have been effectively through the district attorney. It is my understanding that the SEC itself still has an open book on whether it is satisfied that those rules go far enough. It would be my understanding that the SEC intends to conduct further work and that these rules are accepted pro tem but may well be expanded.

Senator CONROY—That is important. That gives me some reassurance.

Mr Knott—As to the second point, I certainly did not wish to infer that we would simply say that because some rules had been introduced in New York they would be adequate here. But it is an industry that is largely owned—more than 50 per cent, as I understand it—offshore. But Mr Rodgers may be able to answer the other part of your question more fully, which is the nature of our surveillance program.

Mr Rodgers—They are related issues. I might just add for the record that, as well as the rules that Merrill Lynch agreed with Mr Spitzer, the formal decision that the SEC has made to this point has been to approve the rules promulgated by the New York Stock Exchange and NASDAQ and approve those rules, which tighten up pre-existing rules in that area.

Senator CONROY—I appreciate that. That was my point in terms of what they are putting forward as opposed to what Mr Spitzer has now delivered via the Merrill Lynch judgment.

Mr Rodgers—I might remind you about the setting in the Australian law. The Australian law does not prohibit conflicts; it requires disclosure of those conflicts. However, I think what we have said publicly about the focus of our interest in the coming months is that we are

concerned about the potential for conflicts to taint the quality of the advice produced by analysts; that we are starting from the premise that there is considerable reliance on analysts' reports in this country, both by their direct subscribers but also indirectly, and therefore quality is an issue for retail investors. We will be focusing on two things. One is what conflicts there are and how the potential for conflict is being managed within the Australian analyst community and then on how well people are disclosing conflicts. We have sent a signal to the market at an early stage saying, 'When you think about disclosure, we are interested in more than mere token crossing the line and complying with the letter of the law.' We think there is a quality issue here as well and we would want to see the emergence and we would want our focus to be on doing what we can within the limits of the legislation to make sure that people are being given useful and meaningful information that will enable them to make a decision about how much reliance to place on a particular analyst report.

Senator SCHACHT—Why do you not just ban the conflict? Rather than make an argument over the disclosure and where the grey line is, why not just say that when there is a conflict it is banned and there is a penalty and you cannot go into court and argue, 'I did not quite understand this was not an interpretation; you've got it wrong, Judge, and we've got it right'? I suspect that is what will happen.

Mr Rodgers—The short answer is that we do not have the power to create an obligation—

Senator SCHACHT—I know you do not have the power; the government decides the policy. But there would be nothing wrong in law if the government or the parliament chose to make a law to say, in relation to conflicts such as Merrill Lynch exposed, which is an outrageous crookedness, in my view—and there is a quorum present—'As soon as it is there, there is a penalty: go to jail for a couple of years.' That will sort people out. Maybe they will get interested in jail reform for a while.

Mr Knott—I think the response to that from us at this stage should be to note that an earlier response by the minister today was that his current intention is that the issue of analysts' conflicts would be included as part of the general range of disclosure issues he intends to have under his review later this year.

Senator SCHACHT—Not just the disclosure rules?

Mr Knott—No. My understanding—

Senator SCHACHT—Do you defer to the one I am raising; that conflict is out and there is no argument about it?

Mr Knott—I have no idea what the minister has in mind in that respect. It seems to me what you are raising are law reform issues.

Senator SCHACHT—I accept that. Someone else makes the law.

Mr Knott—The point I am inadequately attempting to make is that I assume that what the minister has in mind is some process of law reform. I do not know the nature of it or the direction of it, but I assume it must be law reform or he would not—

Senator SCHACHT—But from what you know of Australian constitutional law, if the government or the parliament chose to describe what I have just described, there is nothing to stop us doing it if there was a will in the parliament and the government to do it; to say, 'Under corporations law, once you have a Merrill Lynch case you just cannot do it.'

Mr Knott—You would define the event of conflict that you were seeking to address and prescribe a penalty of some sort if somebody engaged in the conflict.

Senator SCHACHT—I will give you an example of the difference. Under American communications law there would be no judgment about what we call the cash for payment scandal. In America there is no judgment about that; you cannot accept payment. As soon as you do, it is mandatory that you get charged and, if you are found guilty, you go to jail or pay a massive fine or both. In Australia, the law was not as clear cut and you could argue. The only way the Americans found they could deal with payola was just ban it outright; everybody knew what the law was and you took a big risk and got pinged. There is no one argument about interpretation or finding a slick lawyer or barrister to get you around. I suspect this thing on conflict means that in the end, if we have all these investors out there or are encouraging investors, what Merrill Lynch did has to be banned. Once it is defined in the law and someone is found guilty of it, they should face, hopefully, a jail sentence and/or a \$10 million fine. I have to say I suspect most people would think that is a big risk to take.

Senator CONROY—I have two more issues, one for Mr Kell so he does not feel left out. I read in an article recently in the *Australian* that ASIC is moving to restrict the way past performances are used to advertise managed funds. Senator Schacht might be interested in this. What are your concerns there and how can information on past performance mislead?

Mr Knott—Do we have a quorum? I am very unclear as to what is a quorum. But I notice that Senator Watson has left us.

CHAIR—A quorum is one government and one opposition full member of the committee. Senator Schacht and I are both full members of the committee.

Mr Knott—I am relieved. Thank you.

Senator CONROY—Tell us what you really think about the Carlton Football Club.

Mr Kell—In relation to past performance, we decided to look at the use of past performance figures in investment advertisements for a number of reasons. One is that obviously the growth of consumer interest in investing generally means that we are also seeing a growth in the number and variety of advertisements used to promote a variety of investments. A lot of these, we observed, were using past performance figures as a key selling point. As I think is widely understood, we also looked to the fact that past performance is not a particularly reliable guide in most investments to future performance. We were also concerned to ensure that ASIC, as a regulator, was not just simply dealing with, say, the formal offer documents under the regulatory regime but was also making sure that the advertising was not misleading and deceptive. That is the power that we are looking to when talking about regulating investment advertising—our powers to regulate misleading and deceptive conduct. We are seeking to both ensure at that most basic level that any misleading and deceptive conduct in advertising using past performance does not take place. Secondly, we are also seeking to provide some guidance to industry so that that sort of information is used more constructively. We are talking about past performance information used by the managed funds industry, superannuation, financial planners, promoters of margin lending products, and providers of investment newsletters. There is a whole range of players in the financial service industry that use advertisements that promote their excellent past performance. We have taken some enforcement action as a result in this area where we believe the past performance information being used was misleading, because it did not adequately disclose the fact that the information was so-called hypothetically constructed past performance; that is, it related not to the fund being promoted but to another similar fund. We have also had concerns where the past performance being used is old or from a very selective time period that makes the performance look good without adequate disclosure. As you would

be aware, we have come off a period where we have had very strong performance in the markets to a period where we have considerably greater volatility. In that sort of climate we are concerned to ensure that past performance information is used constructively. We are not out to ban the use of past performance. We think there is a demand on the part of consumers for that sort of information, but we want to make sure that as far as possible it is used in a way that is not misleading; that it actually helps consumers make a decision; and also, where possible, that other features of the investment, such as risk, are factored into the equation.

Senator CONROY—What are the current laws governing the advertising of past performance for funds in Australia? Are there any?

Mr Kell—If you are looking at advertising as distinct from the more, if you like, prescriptive regulations governing what is contained in formal offer documents, then as I said you are really going to the misleading and deceptive conduct provisions under the ASIC—

Senator CONROY—What is the position in the UK and the US in relation to advertising information on the past performance of managed funds?

Mr Kell—In both of those jurisdictions there is currently considerable work going on on this subject. The UK situation is different in one rather basic respect from the Australian situation; that is, the UK regulator itself is considering whether it should be publishing past performance information. I am not sure whether you recall, but in the UK the Financial Services Authority had been asked by the government to publish comparative tables on investments. It has had to consider what it might include in those comparative tables. The debate there over the use of past performance has therefore taken place in that context. It has shaped their views on whether they would actually use past performance at all and, secondly, whether they would, for example, ban the use of so-called hypothetical past performance. That is obviously not the situation here. That debate in the UK is still continuing as they have put forward proposals about what features of past performance information they believe should be more tightly regulated. In the US, the SEC has recently announced that it will be looking to more tightly regulate the use of past performance information in advertisements and the SEC has had a longstanding practice of trying to highlight to investors that there are other crucial features to investments that need to be taken into account. We will obviously be looking closely at what happens in those other jurisdictions, but at the end of the day we are also conducting research on the Australian situation and we will make our decisions on how we regulate this based on Australian law and the Australian situation.

Senator CONROY—I had one final issue, and it relates to Pasmenco. I have already mentioned to Senator Brandis that we have the Takeovers Panel with us and I was wanting to call them up as well; I would like to take up a point that I had discussed in previous hearings with ASIC to do with the powers of the Takeover Panel and how we hope would never come into conflict with ASIC. Could we call the Takeovers Panel?

CHAIR—I have asked that that be done. The Takeovers Panel is here.

Senator CONROY—I wanted to explore the issue of Pasmenco and the relief granted from the 20 per cent takeover rule. You would be familiar with that particular case?

Mr Morris—Yes.

Senator CONROY—Mr Knott, are you the relevant officer?

Mr Knott—I am willing to have a try.

Senator CONROY—I do not mind who starts, but for the benefit of Mr Morris, who probably was not aware, I point out that ASIC and I had a discussion about the potential for conflicts to arise in judgments and rulings between the Takeovers Panel and ASIC. I at the time pondered on the legal capacity of the Takeovers Panel to overturn an ASIC decision, particularly given the controversial nature of this case, as it was, the controversial dissenting decision by one of the panel members. I was wondering if I could get, firstly, ASIC's view on whether or not there is a legal basis for the Takeovers Panel to overturn an ASIC finding. Then perhaps, Mr Morris, you might want to respond. So Mr Knott, can I ask you to bounce the ball?

Mr Knott—I do not think there is any question that the Takeovers Panel has the right to review the exercise by ASIC of certain discretions, such as the one that was exercised in the Pasmenco case.

Senator CONROY—Pretty cut and dried as far as you are concerned?

Mr Knott—It is my understanding that there is no substantive dispute on that matter.

Mr Morris—I think Mr Knott is perfectly correct. We think that, yes, it is clear that the Takeovers Panel does have power to review ASIC decisions.

Senator CONROY—It does, did you say?

Mr Morris—It does, and we and ASIC have never had any dispute about that. The panel and ASIC have worked very hard to make sure that the market sees precisely where each of the bodies stand. The panel is a body independent from ASIC. I do not think there has ever been any question. ASIC has never raised any question with us that we do not have the power expressed in section 656A of the Corporations Act. We have a good relationship with ASIC in that respect.

Senator CONROY—Ms Micalizzi is reported as saying that the panel's majority decision meant that there was a risk of harming the public and legislative view of the panel's standing; there were risks to public investors' perceptions of the fairness and equity of markets in Australia; that the panel was being asked to make a decision on the basis of creditors' convenience, not because the relief is needed; that there seemed to be no regulatory benefit outweighing the harm that might be caused to shareholders; and there was no persuasive reason for altering legislative arrangements. A fairly damning set of views, would you say, Mr Morris?

Mr Morris—Strong views in a very complex and difficult application before the panel. It was the first time that a panel had come out with a majority rather than a unanimous decision. There were very good arguments either way and Ms Micalizzi spoke a very strong case. I think that most people who looked at the application recognised that it was very much a decision in balance and that there were strong arguments on either side for either granting the modification or exemption or for rejecting it.

Senator CONROY—What was the legal basis on which the panel could make the decision?

Mr Morris—Section 656A of the Corporations Act, which in essence stands the panel in the shoes that ASIC stands in in terms of section 655A. We consider it to be a de novo review of an application.

Senator CONROY—An application to the panel. Mr Knott, do you concur that that is the power under which they can overturn your decisions?

Mr Knott—Yes. I would certainly not disagree with Mr Morris on such a matter. I would put it in this way: I do not think that there was any question about ASIC's power to grant the relief at first instance if we had been minded.

Senator CONROY—Yes.

Mr Knott—We formed a view, based on our assessment of the application, that we would not grant the relief, and it is fair to say that some of the comments made by Marian Micalizzi reflected some of our concerns or thinking. But I do not think, as I say again, that there is any question that the panel acted within power in reviewing the decision and substituting its own decision.

Senator CONROY—Do you think we have now got a situation where we have got forum shopping between two jurisdictions and we can just shop around to see who we can get the best one out of?

Mr Knott—No, because it was a requirement that Pasmenco would come to us to have the modification made. The situation is effectively that there is a right of review, or right of appeal, if you like, against a decision that somebody does not like, because we face that with reviews to the AAT or whatever. In this case, it just happened—

Senator CONROY—They would be quasi judicial at least or even judicial bodies that would review you?

Mr Knott—Both quasi and judicial, yes. The panel, of course, has been granted its power to exercise a decision. I will stand to be corrected, but I do not think it does so as a review or an appeal in the sense that one would go to the AAT. I think it effectively is acting administratively when it considers the matter and reaches its own determination. That is my understanding of the law.

Mr Rodgers—If I might just remind you, Mr Knott, that is actually the position the AAT is in. It is an administrative review rather than a judicial and it is probably not even quite correct to call it a quasi judicial—

Mr Knott—I am sorry that you interpreted my comments to mean the AAT, because I think my exchange with Senator Conroy made it clear that there are other places to which people can appeal ASIC's decisions, including the courts. There are a range of tribunals and courts in which decisions of ours can be appealed.

CHAIR—I think Mr Morris wanted to say something.

Mr Morris—I would just say that the panel would not see itself as either judicial or quasi judicial. The panel would see itself as administering precisely the administrative powers that ASIC administers. So the panel would not want to—

Senator CONROY—So we have a complete overlap between the two bodies?

Mr Morris—In essence, a review overlap, yes.

Senator CONROY—So everybody who is not happy with a takeover decision by ASIC from now on knows they come to you as a court of appeal?

Mr Morris—As they could have gone to the Administrative Appeals Tribunal before the Takeovers Panel was given this particular power, yes.

Ms Redfern—As they can now—

CHAIR—But not as a court of appeal, Mr Morris, because of course you do not exercise judicial power.

Mr Morris—Absolutely, yes.

CHAIR—I am sorry, Ms Redfern.

Ms Redfern—I was saying: as they can now on a number of our decisions about licences and bannings, and they do.

CHAIR—Yes.

Senator CONROY—How many other decisions have been made which overturn ASIC decisions?

Mr Morris—I do not precisely remember. I think we have had in the region of six or eight applications for review of ASIC decisions. In about half, or a little over half, the panel has affirmed the ASIC decision and in something less than half the panel has either varied or overturned the ASIC decision. It is that sort of ballpark number.

Senator CONROY—I actually did not realise it had happened before. Does that accord with your recollection, Mr Knott?

Mr Knott—I would really need to check that, but I am not aware of any other case where—

Senator CONROY—No-one has mentioned to you that you had been overturned.

Mr Knott—It may have happened, but I am not aware of it.

Senator CONROY—Mr Rodgers?

Mr Rodgers—I simply do not know. I think what was unusual about the panel's decision in this case, as Mr Morris has mentioned, was that it was a majority decision rather than a unanimous one, and that is what drew attention to it.

Senator CONROY—I am finding it extraordinary that ASIC have been overturned three or four times, according to Mr Morris, and you do not even know.

Mr Rodgers—I regret to say that we are from time to time overturned in the AAT, which is pretty much a parallel situation. It is not so unusual an event that I think it would be at the forefront of my mind.

Senator CONROY—But you would know—you would have representation, you would have argument there, wouldn't you? Are you represented at AAT hearings?

Ms Redfern—Yes.

Senator CONROY—You are represented at the Takeovers Panel?

Mr Knott—I am happy to take it on notice. I am not aware of any other case, but I defer to Mr Morris on the matter.

Mr Morris—Senator, I think, on Pasmenco, none of the other matters that we are referring to have quite the same profile or—

Senator CONROY—Sure. I am actually more interested in the principle. I find it disturbing that the panel feels that it can overturn ASIC's decision.

Mr Morris—Personally, I do not think that you ought to find it disturbing. There are differences of view between sensible people, sensible regulators, and as Mr Knott said—

Senator CONROY—I have never thought of you as a regulator.

CHAIR—Sorry, Mr Morris. Just finish your answer, please. I want to give you the opportunity to explain.

Mr Morris—As Mr Knott said and Mr Rodgers said, before the Takeovers Panel came along, ASIC takeovers, modification exemption decisions, were reviewed by the AAT and the AAT came to different conclusions to ASIC in various of those circumstances. As we have said before, there are other decisions currently of ASIC that are still reviewed by the AAT and from time to time the AAT comes to a different decision to ASIC. I do not find it particularly disturbing.

Senator CONROY—How many other decisions have you made which grant relief from the application of the Corporations Act?

Mr Morris—Those would be within the three to four applications for review of ASIC decisions, and two or three of those have been to exercise the power that ASIC has, because that is what section 656A does. It says—

Senator CONROY—So you believe that you have got the power to waive the Corporations Act?

Mr Morris—Indeed, yes.

Senator SCHACHT—Can I ask a question while we are on Pasmenco?

Senator CONROY—Only if you promise to be quick, because I have got to do ACCC.

Senator SCHACHT—As a South Australian, and with Pasmenco being a major employer in South Australia with the smelter at Port Pirie, I found it came as a bit of a shock to most of us that a company that seemed to be not brilliant but going along, that had been there for literally generations, suddenly, overnight almost, just goes into serious financial strife, and that that had nothing to do with the productive capacity of the smelter, or the mine, or the world marketplace, other than foreign currency arrangements. There is nothing in the way that they got into that mess that would draw the attention of ASIC to say, 'We might have a look at what the directors did here.' How come a company that was, as I say, not brilliant but sailing along, suddenly out of the blue, just crash—bang—with extraordinary losses. They did not get the acid wrong in the smelter, the mine did not collapse, the world market did not collapse—it was just to do with currency exchanges. Is that just too esoteric an issue for ASIC and you say, 'That is just good and bad management—investors beware'? Or is that sort of dramatic change something that ASIC could look at and say, 'What were the directors doing?'

Mr Knott—Obviously with a collapse of that size it does attract the attention of ASIC—as it did. I think you may oversimplify the situation by referring only to currency losses, although I concede that they were a huge part of the problem. But so too were commodity prices for that company. They came together tangentially in the worst possible way. The collapse, whilst one might describe it as sudden—I think I understand that description—nevertheless emerged over a number of months where we monitored the company from a disclosure point of view and therefore got to start to understand the issues. The position was that the banks until, I think, about September were supporting the company and indicating they would support it, and then negotiations between the company and the banks broke down and the banks withdrew their support.

Of course, when that happened, forward transactions, currency transactions, became crystallised. They appointed an administrator. That was an event of default. That crystallised

contracts and suddenly the deficiency in the company had to take account of massive crystallisation of contracts that were out of the money. So it certainly did look very sudden and it certainly did and was bad. We made inquiries. We have had a number of discussions with the administrator over time. Our position is that there is no evidence that has been available to us that suggests that the directors acted in breach of the law.

Senator SCHACHT—Okay. One last question on this issue and criticism elsewhere. Do you think if boards—of Pasmenco and many other companies—had a higher proportion of independent non-executive directors with a tougher view towards management, then some of these things might not have occurred? Is that a structural way to try to prove performance generally?

Mr Knott—May I take the question as a general question?

Senator SCHACHT—Yes, in general, not about Pasmenco.

Mr Knott—While I personally am a great supporter of a diversity of skill and talent on a board, I think in many cases the difficulties in companies arise when you have very strong-willed management and compliant directors. Over the course of history we have seen that time and again. I think we have seen some of it in the latest spate of collapses, but we have also seen other situations. But in general terms, yes, we need strong-minded, qualified, skilled directors who understand the law, who understand the commercial requirements but also understand the industries that they are running. We need to do a lot more training in this country, both of a technical type and of a general type, for directors.

Senator SCHACHT—Thank you.

Senator CONROY—I just have one final question for Mr Morris.

Senator WATSON—Just before that, in relation to Pasmenco—

CHAIR—I am sorry, Senator Conroy. Does this arise out of Senator Schacht's question?

Senator WATSON—Yes, it does; it is in relation to Pasmenco. Has the administrator or liquidator given a declaration in terms of the requirements of the Taxation Act about crystallising the losses for shareholders? It is an unusual set of circumstances.

Mr Knott—I am not aware that he has done that.

Senator WATSON—There is a liquidator there, isn't there?

Mr Knott—An administrator.

Senator WATSON—It might be difficult for an administrator to perform that act. It is generally the liquidator who has got to make that decision. Thank you.

Senator CONROY—Mr Morris, I was just wondering if I could get a list of the decisions which have overturned ASIC findings or rulings and if I could get a list—and this may be the same list—of decisions to vary the Corporations Law?

Mr Morris—We can provide that. The decisions are on the panel's web site. I will send you a list of applications under section 656A and the outcome in each of those cases.

Senator CONROY—And if I could just put it on the record that I do find it disturbing that ASIC's rulings have been overturned and I share the dissenting report's views, particularly the first point that I read out regarding the public confidence issue that arises out of these events. I may have more to say on that in another forum. Thank you very much for coming.

CHAIR—Have you finished with Mr Morris?

Senator CONROY—Yes.

CHAIR—Senator Schacht?

Senator SCHACHT—I have not finished with Mr Morris. Are there more questions of ASIC?

Senator CONROY—I have questions for ACCC. We are going to be finished in half an hour.

Senator SCHACHT—I want to put a question to ASIC. At another estimates hearing last week—I think this has been raised at two estimates—I raised a case of a project which was community based and got funding through Networking the Nation. A company was established. You might talk about people blundering into a structure; there might have actually been people who had shaved the edge a bit. The department had its own review about the project and admitted that it now has to adopt a whole series of new processes to stop public money going into these sorts of projects et cetera. Secondly, a liquidator has been appointed. The report will come in soon. This can be taken on notice. Has anyone from the south-east of South Australia or the western district of Victoria laid a complaint about the collapse of a company called Green Phone Inc. or about its parent group that started it, called the Greater Green Triangle Development Association. I suspect there will be a fair bit of interest in the south-east, if you do have a look at it, and you await the liquidator's report.

A second issue is this. I know you have limited resources, but how do you handle the monitoring of something where, with all the best will in the world and with a great idea, a community puts together a mixture of government funding, raises local private equity, and runs the arrangement, with well-meaning community directors being appointed, but the project runs into a brick wall because they do not have the necessary skills and the management makes the wrong decision, with the result that a year or so later everyone has taken a bath? That is a colourful way to describe it. It does not always happen, but there are a few examples around. Again, you might want to take this on notice. Is there any particular way ASIC can provide advice other than 'Read our the web site'? Some people are stumbling into this with the best will in the world and then later on we are all sitting around saying, 'Taxpayers's money has gone down the hole, investors' money has gone down, and the community has been left with a very bad taste in the mouth.'

Mr Knott—In fact, you may recall that you raised this matter when I last appeared before estimates.

Senator SCHACHT—In February.

Mr Knott—I did take it on notice then—

Senator SCHACHT—You must have sent me an answer. I am sorry.

Mr Knott—I supplied an answer on 18 March to the secretary—

Senator SCHACHT—I apologise for forgetting about it.

Mr Knott—Without going at length through that answer, the fundamental point on the particular company is that it is incorporated under the state law and is administered by the state authority. That is often the case with these incorporated associations.

Senator SCHACHT—Is that a way in which people can escape monitoring and regulation on good governance issues—the fact that it is not in your purview as a federal body?

Mr Knott—They certainly are not in any way regulated by ASIC.

Senator SCHACHT—Does that mean that, because they go through only the structure of state regulation—whereas you impose regulation because the parliament has carried it and you administer it—the regulation for good governance, in the broadest terms, is deficient?

Mr Knott—I am reluctant to reflect on the standard of regulation through, for example, the South Australian Office of Consumer and Business Affairs. But I can safely say that that office would not have the legislative framework that ASIC has under the Corporations Act.

Senator SCHACHT—And you cannot do it because constitutionally it has not been referred to you?

Mr Knott—Correct.

Senator SCHACHT—You would have to get the states to further amend their complementary legislation under Corporations Law for you to be able to take a role in that area? It is a legislative change?

Mr Knott—Mr Rodgers is indicating that there may be other ways that that could be achieved. But essentially it would be the states vacating the field of incorporated associations and saying that the only form of incorporation should be through the Corporations Act.

Senator SCHACHT—That is probably it. I am a nationalist, and so I think that should happen, actually.

CHAIR—I thank Mr Knott, the officers of ASIC and Mr Morris.

Mr Knott—There is one matter for the record that I think Mr Rodgers would like to record very briefly for Senator Conroy's benefit.

Mr Rodgers—You asked me a question about a review of the ASX-SGX arrangements and you mentioned three months. In the evidence I gave to the Senate Economics Committee in January, I said that we had advised the minister that it would require a review after 12 months and that we were intending to carry that review out then.

[10.35 p.m.]

Australian Competition and Consumer Commission

CHAIR—I recall to the table officers from the Australian Competition and Consumer Commission. Thank you, gentlemen, for your patience in you interrupted testimony. Mr Cassidy, I was not in the chair when you were initially called. I understand there were some questions from Senator Allison specific to the tobacco industry. Do not feel obliged, but do you wish to make an opening statement?

Mr Cassidy—No; given the hour, I think I will pass that offer up.

CHAIR—We will finish at 11 p.m.

Senator CONROY—In the context of the now announced inquiry into the Trade Practices Act, are there other issues that the ACCC would like to see the review consider?

Mr Cassidy—We have signalled some issues that we will certainly be raising in our submissions to the review. From looking at the announced terms of reference, it seems to us that they are sufficiently broad to allow us to raise those issues, and so we will obviously be doing so.

Senator CONROY—Have you got enough time to get your submission in? Four weeks is not long.

Mr Cassidy—I think so. I must say we were caught a little by the timing. On the other hand, we have been thinking for a while, obviously, about the issues we want to raise and have been doing some work. I think we are reasonably placed. We will probably not be in right on 21 June, but the advertisement calling for submissions indicated that if people need extensions of time the committee would be willing to consider that. We will be approaching the committee probably for about another week or so, I suspect, after 21 June. Certainly, we are aiming to have ours in by the end of June.

Senator CONROY—When do they close?

Mr Cassidy—21 June is the advertised date.

Senator CONROY—Thanks. I would like to ask some questions regarding late payments by big business for goods and services provided to them by small business. But, first, what constitutes ‘unconscionable conduct’ under the Trade Practices Act?

Mr Cassidy—It is not easy just to give a black and white answer to that. These things often are not easy. We would need to establish that there is, if you like, a consistent pattern of late payment; and indeed it is probably related to other dealings between the purchaser and the seller of the goods and services, so that the late payment is part of a more general pattern of conduct which, when taken in its totality, would be perhaps seen as being unconscionable.

Senator CONROY—If, due to late payments by big business, small business is experiencing severe cash flow problems and is potentially subject to interest penalties for remitting GST payments late to the ATO, are these circumstances that you would consider in determining whether conduct had been unconscionable?

Mr Cassidy—Again, I do not know that that necessarily changes my previous answer. That is one manifestation of the problems that can arise from late payment, but you could equally construct a situation where a supplier is receiving late payments from the purchaser of its goods and services and that in turn is causing problems for the supplier with, say, its banker or its suppliers in turn. If you like, that is one manifestation of the broader issue.

Senator CONROY—But it is possible that this could constitute unconscionable conduct?

Mr Cassidy—It could. It would all depend on the circumstances.

Senator CONROY—If a company is to be fined by the tax office because it is not able to remit its money in time because big business has not supplied it with—

Mr Cassidy—As I say, it would go beyond just the fact that a—

Senator CONROY—If there were a consistent pattern.

Mr Cassidy—Where either a company is consistently late or where there is an element of intent, as it were, which was part of a broader range of conduct which, when taken together, could be seen as being unconscionable.

Senator CONROY—Did the ACCC recently receive extra funds to mount legal cases on behalf of small business?

Mr Cassidy—Not recently. We received funding three or four years ago, particularly in relation to the then new unconscionable conduct provisions, for us to be testing those provisions and in a sense seeking the court’s clarification of the reach and extent of those provisions.

Mr D. Smith—We are investigating some slow payment issues.

Senator CONROY—I was going to ask whether these cases of late payments would be something the ACCC would consider prosecuting, but obviously you are actively considering that.

Mr D. Smith—Yes. There are some issues we are looking at.

Senator CONROY—I understand that Mr Martin, the Small Business Commissioner, is investigating the particular case of crash repairers who have some tie-in with insurance companies and are being paid more quickly than independent repairers. What are your concerns there? Is Mr Martin with us?

Mr D. Smith—No, Mr Martin is not here. I am head of the Compliance Division. I do not have specifics of the actual matter, but I do understand there has been communication with that industry. Commissioner Martin has been involved in those discussions. I understand that the VACC is perhaps looking at a possible code to assist that issue as well.

Senator CONROY—Do those codes need to be approved by you? Are they voluntary or binding? Are you able to give them more than just a voluntary basis, if you tick them off?

Mr Cassidy—The motor vehicle industry is one of a couple of industries at the moment where we are talking to the participants about having some sort of voluntary code to start with. We have a couple of industries—retail tenancy is another one—where we get quite a lot of complaints. But the complaints really fall outside the Trade Practices Act and are more between an individual purchaser and an individual supplier—almost in the nature of contractual sorts of issues—and we think that some sort of code would help avoid a lot of these issues.

Senator CONROY—How enforceable would that code be?

Mr Cassidy—Initially, it would not be enforceable by us. Some of these codes do have their own dispute resolution type of process built in. Certainly, the government's stated policy is that, before they move to mandatory codes under part 4B of the Trade Practices Act, they like to see a voluntary code tried, to see whether it is effective.

Senator CONROY—What is the next step? When do you actually get the powers to enforce that? How does that happen?

Mr Cassidy—If the government decides to prescribe a code, either in whole or in part, under part 4B of the Trade Practices Act, it becomes enforceable by us.

Senator CONROY—What about public liability insurance? The national summit on public liability insurance last week mentioned amendments to the Trade Practices Act to allow self-assumption of risk by people who chose to participate in inherently risky activities such as adventure tourism and sports. Were you consulted on this prior to the national summit?

Mr Cassidy—The idea has been floated both at the Commonwealth and at the state government level. We had some preliminary discussions with Treasury on the possibility. There is still a reasonable amount of work to be done on that idea.

Senator CONROY—Someone has been in touch since the summit, in order to follow up?

Mr Cassidy—Again, we are now in discussions with the Treasury. We are awaiting the appointment of the three-person panel that was foreshadowed. We understand that it will be primarily looking at the issue—given, as I understand it, that a lot of the other legal issues involved are in fact issues for the states.

Senator CONROY—The communique from the national summit also says that the ACCC will monitor market developments and premium prices, and that the Commonwealth will review the ACCC's involvement, including in more formal processes. If it becomes clear that cost savings are being made but not being passed through to consumers, what powers do you currently have to monitor developments in the insurance market and insurance premiums?

Mr Cassidy—The powers that we have are basically in the Prices Surveillance Act. Those powers are not available to us of our own volition. We require them to be triggered by the government.

Senator CONROY—You have received no trigger from the government?

Mr Cassidy—Not yet.

Senator CONROY—Are you expecting one?

Mr Cassidy—Certainly, in terms of what is in the communique, we would expect one, otherwise we will not be able to do what is foreshadowed in the communique.

Senator SCHACHT—But a formal letter from the Treasurer or the Assistant Treasurer has to arrive on your desk to trigger it? A statement is not formal notice?

Mr Cassidy—Yes. Assuming what is in mind is what we call 'formal monitoring' under the Prices Surveillance Act—which means we can use, if we need to, the compulsory information acquisition powers under the act—in terms of the act, we do need a direction from the Treasurer or from Senator Campbell—

Senator SCHACHT—Just a formal document?

Mr Cassidy—Yes; that is right.

Senator CONROY—It is not a press release?

Mr Cassidy—No. It would in fact be similar to the dairy exercise involved—

Senator CONROY—Just to reread it again, the Commonwealth will review 'if it becomes clear that cost savings are not being passed on'. I do not get the impression that that is an imminent.

Mr Cassidy—I think there are two parts to that statement. I have to immediately say that, in relation to the part you just read out, I do not have any particular insight as to what that means. I was really looking at the first part of the statement that refers to us monitoring.

Senator CONROY—But you do not need a formal request for you to monitor?

Mr Cassidy—We do require a direction, if we are going to undertake formal monitoring.

Senator CONROY—What about the formal processes that they are referring to in the second bit?

Mr Cassidy—I have got no idea. I was not involved in the drafting of that communique. I am afraid I cannot help you on that.

Senator CONROY—It is just that the impression I get from this document is that they want you to keep doing what you are doing now, and then they will consider giving you the more formal process; that is, the letter.

Mr Cassidy—As I say, we are in much the same boat that you are in, in that we have seen and read what has been said. We have had some early discussions with Treasury, mainly on

the issue of amendments to the Trade Practices Act, but we have not had any clarification yet on the sort of monitoring and reporting issue.

Senator CONROY—What would be the sanction if insurance companies are not passing on cost savings from tort reforms?

Mr Cassidy—If that is what the government asks us to do, in terms of our powers under the Prices Surveillance Act, there are no sanctions embodied in that act. It is purely a monitoring role where we report on what is happening with—

Senator SCHACHT—You say, ‘Tut, tut.’

Senator CONROY—A loud tut-tut.

Mr Cassidy—As the name says, it is a monitoring role.

Senator CONROY—In relation to the GST, the ACCC was given extensive powers to ensure there was not price exploitation. In order to determine whether there was price exploitation, did that require the ACCC to determine the cost structure of the business?

Mr Cassidy—In a number of cases it did. Not necessarily the entire cost structure—typically what often happened was we went and queried companies on whether they had passed on the savings from the GST and—

Senator CONROY—I remember you produced a calculator. I remember this at length. I think only you were with us, Mr Cassidy, from the looks on the faces here, although possibly we have another suspect here. You produced a price calculator where you actually looked at things like net dollar margins on each good a business sold, whether overheads had fallen due to reductions in input costs—

Mr Cassidy—That is right. The point I was going to make was that because it was about movements or about change we did not actually need to establish the cost structure of a firm. What we needed to establish was how it had changed or how it had increased during the particular period in question.

Senator CONROY—Are you pretty happy with the job you did then, which was a pretty complex one?

Mr Cassidy—Yes, reasonably so. As you say, it is a complex one and I must say that I suppose it is a bit in the nature of business that there are always costs that are increasing. Some of those issues involved a reasonable amount of judgment on our part, at the end of the day, to decide whether there had been offsetting cost increases.

Senator CONROY—Did you need to bring in any outside expertise to help you in that GST monitoring role?

Mr Cassidy—On occasion. Depending on the particular firm or industry we were looking at, we did bring in some outside consultants.

Senator CONROY—Chris Murphy got a guernsey, from recollection.

Mr Cassidy—I think we made very limited use of him, but he was more, if you like, in terms of aggregate type effects rather than individual industries.

Senator CONROY—But you had access to all the experts you needed if you needed them?

Mr Cassidy—Yes. We had to obviously, in a sense, buy them in, but we could use them if we needed to.

Senator CONROY—Do you think without the role you played that all the cost savings from the GST would have flowed through as quickly to consumers?

Mr Cassidy—I suppose our answer would be no in a sense that we think we did our monitoring role, the surveys we were doing and so forth—

Senator CONROY—It was enforcement as well as monitoring, and there was some high profile enforcement.

Mr Cassidy—That is true. There was a whole package—the information component, the monitoring and the surveys and also the enforcement actions. I think all that contributed to savings being passed on more fully and quickly than they otherwise would have been.

Senator CONROY—In relation to the GST, what was the sanction if prices were found to have increased by more than 10 per cent?

Mr Cassidy—It was the same as for a breach of the competition provisions—a maximum fine of \$10 million.

Senator CONROY—Let me just get this right. If insurance companies do not pass on the savings, there are no sanctions currently.

Mr Cassidy—That is right, as it all currently stands, yes.

Senator CONROY—But to ensure the GST savings were passed on there was \$10 million—a pretty big difference.

Mr Cassidy—That is the law as we had it to administer.

Senator CONROY—I am in no way casting any reflection on the ACCC, just on the seriousness of—

Senator SCHACHT—As I understand it on these matters, Professor Fels is now arguing that there should not only be a \$10 million fine but a jail sentence. Is that right?

Mr Cassidy—Within the competition provisions we have some things—

Senator CONROY—Price fixing.

Mr Cassidy—Yes, if you like, some offences which relate to whether they substantially lessen competition or not, and—

Senator SCHACHT—I just say that in any of these areas, if people are into these sorts of major abuses, I think until you give jail sentences to some characters you will never get the compliance to the level the community would expect.

Mr Cassidy—Just to finish my answer, we also have some offences such as price fixing which are what we call per se offences—in other words, they are just outright breaches of the act. It is those sorts of offences where we are arguing and will be arguing that there should be criminal sanctions.

Senator SCHACHT—Hear, hear!

Senator CONROY—I have other questions but, given the lateness of the hour, I am happy to put them on notice. I know you have been dragged in and out a few times tonight. I appreciate and thank you for your patience. Thank you.

CHAIR—Thank you very much indeed, Mr Cassidy, and officers of the ACCC. That concludes the examination of the budget estimates for the Treasury for 2002-03. I thank the committee secretariat, parliamentary sound and vision, and the witnesses. I remind witnesses that the date for questions taken upon notice will be 19 July 2002.

Committee adjourned at 10.55 p.m.