FINAL REPORT

of

THE ROYAL COMMISSION

into the

TRICONTINENTAL GROUP OF COMPANIES

31 AUGUST 1992

VOLUME 2 -
FINAL REPORT

of

THE ROYAL COMMISSION

into the

TRICONTINENTAL GROUP OF COMPANIES

31 AUGUST 1992

VOLUME 2

Ordered to be printed

MELBOURNE
L. V. NORTH, GOVERNMENT PRINTER
1992
CHAPTER 15

THE RESPONSIBILITIES OF TRICONTINENTAL’S DIRECTORS

A. Membership of Tricontinental Board

15.1 Until March 1985 the composition of the Tricontinental board reflected the ownership of Tricontinental by a consortium of banks. SBV had a 25.8% interest, and was represented by two directors.

15.2 At the end of March 1985 SBV assumed control of Tricontinental’s operations, and later that year arranged to acquire 100% ownership. From April 1985 the board was, but for one exception, nominated by SBV; see para 18.7 of the first report.

15.3 The details of the appointments to the Tricontinental board, resulting from changes in April 1985, January 1986, May 1989 and August 1989 are set out in chapter 18 of the first report. The relevant directors of Tricontinental during the crucial period, January 1986 to May 1989, were: N A Smith (chairman), J F Ryan (deputy chairman), I M Johns (managing director), B A Ziebell, L G C Moyle, J St G D Rawlins (to April 1988), R M Carr (from April 1988) and I K Morton.

15.4 Mr Carr had also been an alternate director, mainly for Mr Moyle, from September 1985 until April 1988, when he was appointed a director in his own right.

B. Qualifications and Appointments of Tricontinental’s Directors

15.5 Chapter 18 of the first report refers to the backgrounds of Tricontinental’s directors, but it is appropriate to set out the details here, to show the nature
of the qualifications and experience brought by members to the performance of the board's functions. For the purposes of the Commission's inquiry, the most relevant functions of the board were:

- formulating Tricontinental's objectives and policies
- ensuring that appropriate operating systems and practices were in place
- approving major credit submissions
- supervising investment banking activities
- monitoring the state of Tricontinental's business generally.

15.6 Mr Johns' background has already been examined in considerable detail in chapter 13, and nothing needs to be added here. Mr Hancock was a director of Tricontinental for a short period from April 1985 to December 1985, and again for a short period from August 1989 to February 1990 after Tricontinental was integrated into SBV. It is more appropriate to consider his background in chapter 16, which deals with the role of SBV directors. Mr Hancock was chairman of the SBV board from 1983 to February 1990.

15.7 Accordingly, attention in this and the following section of this chapter is confined to matters concerning the backgrounds and respective roles of Smith, Ryan, Moyle, Rawlins, Carr, Morton and Ziebell.

15.8 Neil Andrew Smith AC, CMG, D Ed (Hon)

(i) Formal qualifications: Accountant - AASA, ACIS, FAIE

(ii) Commercial background:

Mr Smith's commercial activities and public offices included (but were by no means confined to) the following -

1959-1968: Executive director, Ansett Transport Industries Vic

1968-1983: Chief executive officer and director, Gas and Fuel Corporation of Victoria

1975-1980: Chairman, State College of Victoria

1981-1982: Commissioner, City of Melbourne


1983-1990: Director, Tricontinental (chairman from 1986)

1983 onwards: Chairman, 1983 Bush Fire Appeal Trust

1984-1987: Chairman, Australian National Airlines Commission (TAA)


1988-1989: Director, HSV Channel 7 Pty Limited (invited by Mr C Skase).

(iii) Appointment to Tricontinental Board:

Appointed: 5 May 1983
Chairman: 1 January 1986
Resigned: 26 May 1989
Re-appointed: 15 August 1989
Resigned: 22 February 1990

He was also a member of the audit and accounting committee.

(iv) Appointment to SBV board:

Appointed: 21 September 1982
Deputy chairman: December 1984
Resigned: 16 February 1989
Re-appointed: 6 June 1989
Resigned: 23 February 1990

In January 1989 Mr Smith was appointed chairman of Australian Bank Limited, pending the conclusion of negotiations to merge Tricontinental with it. Due to Reserve Bank of Australia constraints upon common directorships of major banks, he resigned for the time being from the board of SBV. After the collapse of Tricontinental,
and the failure of the proposed merger with ABL, he was re-appointed to the board of SBV. Thus he was not a director of SBV in May 1989 when the decision was made to integrate Tricontinental into SBV.

15.9 Jack Francis Ryan

(i) Formal qualifications: Accountant - AASA

(ii) Banking background:

1941: Started with SBV
1973: Assistant chief accountant
1976-1978: Seconded to Westralian International Limited as chief executive
1978: Established SBV's corporate lending department
1983: Deputy general manager - finance
1984: Acting chief executive officer until the appointment of Mr Moyle
1984-5: Deputy chief executive officer and assistant to the general manager, until retirement in July 1985
1985: Seconded to Tricontinental as managing director (see below)

(iii) Appointment to Tricontinental Board:

Appointed: 3 April 1985
Deputy chairman: 1 January 1986
Resigned: 15 August 1989

Mr Ryan was managing director between 3 April 1985 and 31 December 1985. He was a member of the audit and accounting committee from May 1986.

(iv) Appointment to SBV:

His career with SBV is noted above. He was not a commissioner or director of SBV.
Lindsay Gordon Crossley (Bill) Moyle

(i) Formal qualifications: Accountant - AASA, CPA, FASA

(ii) Banking background:

When he joined the Tricontinental board in 1985, Mr Moyle already had about 38 years of experience in banking, merchant banking and finance.

He joined the Commonwealth Bank in 1947 after matriculation, and remained until 1978. Experience was gained in general banking, marketing, personnel management, research positions and the savings bank. Six to nine months were spent in corporate lending.

In 1974 Mr Moyle became a deputy chief manager of the Commonwealth Bank.

In 1974 he was appointed general manager of Australian European Finance Corporation Limited, a merchant bank affiliated with the Commonwealth Bank. He was then managing director of United Dominions Corporation Limited, a merchant bank, from 1978 to 1981, and managing director of Chase-NBA Group Limited, another merchant bank, from 1981 to 1984.

(iii) Appointment to Tricontinental Board:

Appointed: 3 April 1985
Chairman: 26 May 1989
Resigned: 22 February 1990

He was a member of the audit and accounting committee from May 1986.

(iv) Appointment to SBV:

In August 1984 Mr Moyle was appointed chief executive officer of SBV, and following amendments to the State Bank legislation in May 1988, was appointed as a director. He was a member of SBV's credit committee. As CEO, he was regularly in attendance at SBV board meetings before May 1988 to report upon operations by SBV and its subsidiaries. He resigned as a director from 23
February 1990, and after a period of leave, resigned as chief executive officer in May 1990.

15.11 John St George Delme Rawlins

(i) Formal qualifications: BA (Hons) Honours degree in modern languages (with economics as a subsidiary field of study). Post graduate research course in economic history.

(ii) Banking and stockbroking background:
1965: Research Department of J B Were, stockbrokers - preparing industry studies.
1965 to 1966: Conzinc Riotinto of Australia - money market operator.
1966 to 1968: Australian United Corporation - assistant to the treasurer.
1968 to 1977: Peter Haines and Company, stockbrokers - initially appointed to establish a research department, became a partner in 1972.
1977: Seldon and Associates Pty Ltd - corporate advisory section.
1977 to 1984: Commercial Banking Company of Sydney - initially appointed to establish an underwriting department, appointed chief manager of money market operations in March 1982, and chief manager - domestic and international funding in June 1982.
1984: SBV - appointed assistant general manager - treasury division.

(iii) Appointment to Tricontinental Board:
Appointed: 3 April 1985
Resigned: 21 April 1988
Mr Rawlins was not a member of the audit and accounting committee.

(iv) Appointment to SBV:

As a result of his considerable experience in money market operations, treasury functions and stockbroking, Mr Rawlins was recruited to SBV by Moyle in 1984 to develop SBV's treasury operations. In 1984 he was appointed as assistant general manager - treasury division.

Upon resignation from the Tricontinental board in April 1988, he was appointed by SBV to the board of Burdett Buckeridge & Young, SBV's stockbroking subsidiary.

In September 1988, he was appointed SBV's deputy general manager - treasury division.

15.12 Raymond Maxwell Carr

(i) Formal qualifications: Accountant - B Com, FASA, CPA

(ii) Banking and administrative background:

Mr Carr started work as a clerical officer with SBV in 1949 and remained with SBV until 1990.

From 1959 to 1983 his SBV experience included systems analysis and computer programming, electronic data processing, internal audit, management of SBV's U.K. and European activities, and corporate secretarial responsibilities.

From 1983 to 1985 he was deputy general manager - administration, responsible for accounting, computer and information systems, planning and operations, corporate planning, internal audit and properties.

From 1985 to 1990 he was deputy chief executive officer, responsible for control of the retail banking, management services, and chief executive officer's divisions of SBV.

Mr Carr did not gain any corporate lending experience within SBV, except as a member of the credit committee.
Appointment to Tricontinental Board:
Appointed: 21 April 1988
Resigned: 15 August 1989
He was previously an alternate director, from September 1985 until appointed director in April 1988.

Appointment to SBV:
Mr Carr was never a commissioner or director of SBV but, as deputy chief executive officer, he attended most SBV board meetings between 1985 and 1990, to provide backup for, or to act in place of, Moyle. He was a member of SBV's credit committee from September 1985.

15.13 Ian Kenneth Morton AM

(i) Formal qualifications: Bachelor of Commerce.

(ii) Banking and commercial background:
1971-1990: Commissioner and director of SBV.

(iii) Appointment to Tricontinental Board:
Appointed: 1 January 1986
Resigned: 26 May 1989
Appointed: 15 August 1989
Resigned: 23 February 1990
Mr Morton was a member of the audit and accounting committee from May 1986.
(iv) Appointment to SBV board:
Appointed: August 1971
Resigned: 23 February 1990
He was a member of SBV credit committee from about 1985, and acted as deputy to the chairman.

15.14 Bruce Albert Ziebell

(i) Formal qualifications: Accountant - AASA, FCIS, CPA
Diploma of Business Studies from the Phillip Institute. Graduate Diploma of Accounting from Swinburne Institute.

(ii) Accounting and administrative background:
Mr Ziebell joined Tricontinental in 1973 at age 21, as assistant to the group accountant.
In 1974 he became corporate accountant, responsible for supervision of non-money-market lending and preparation of accounts.
In 1976 he was promoted to group accountant, responsible for all the accounting systems of Tricontinental.
In September 1980 he went overseas, but returned to Tricontinental in November 1981.
In February 1982 he was appointed company secretary and in March 1982 he was appointed general manager administration.
Mr Ziebell was very much an administrative person within merchant banking. He had no experience in lending, had never traded shares and had never been on the trading desk.

(iii) Appointment to Tricontinental board:
Appointed: 3 April 1985
Resigned: 22 May 1989

(iv) Appointment to SBV
Mr Ziebell had no appointment in SBV.

15.15 The Commission makes the following findings concerning the qualifications of Tricontinental directors:
(i) The Commission finds that at the time of appointment each of the directors brought to the board substantial experience in a relevant field or fields of activity. These included commercial and semi-governmental operations and administration (Smith, Morton), general banking operations and administration (Ryan, Moyle, Carr, Rawlins and Morton), merchant banking accounting and administration (Ziebell), money market operations and stockbroking (Rawlins), and corporate lending (Johns, Moyle, and to some extent Ryan).

(ii) Plainly there was not a wide spread of specific expertise or experience in corporate lending, which became the focus of attention at Tricontinental. Mr Johns' experience had been short but intense. Mr Moyle's experience had been long and comprehensive. Mr Ryan's exposure had been somewhat spasmodic, including as it did a period as chief executive of Westralian Holdings from 1976 to 1978, establishing a corporate lending division after returning to SBV in 1978, and acting as managing director of Tricontinental from April to December, 1985.

(iii) The Commission does not accept the proposition that more members of the board should have been technically skilled and experienced in merchant banking. In the real world, it is not a practicable proposition that most members of a board should be skilled in the specific activity of the corporation. Even if it were possible to achieve that position, it would probably not be desirable to do so, because it would very likely mean that other skills or experience of value to the corporation were excluded.

(iv) Obviously, the Tricontinental board needed to have a sufficient number of directors who had technical merchant banking expertise, so that they could recognize whether the specific policies, management structure, operating systems and practices required by a merchant bank were in place, and functioning effectively. Preferably, there would be both executive directors and non-executive directors who possessed those skills. It was also
appropriate, however, for directors with other skills and experience to be appointed to the board, to contribute expertise from other areas.

(v) In *Southern Resources v Residues Treatment* (1990-1991) (3) ACSR 224 at 225, Jacobs ACJ, Prior and Mullighan JJ observed:

"It is a commonplace of commercial experience that directors contribute different skills, especially in large and complex corporations; issues will often arise for decision in which a director will necessarily have to rely to a large extent on the knowledge and experience of others; and when it is said that directors must exercise an independent judgment, that means no more than that they, having listened to and assessed what their colleagues have to say, must bring their own mind to bear on the issue using such skill and judgment as they may possess."

(vi) The collective skills and experience of the Tricontinental directors appeared adequate for a merchant bank board, at the time when the members were appointed. It was reasonable to expect that they would apply a variety of skills and experience to the board’s functions both diligently and collectively, so the fact that only some of them had specific corporate lending experience should not have been a problem.

(vii) As it turned out, one of the major problems was the lending strategy adopted by the board, yet that was an area in which the non-executive directors with commercial lending experience (Moyle, Ryan) were in a position to exert considerable influence, had they so chosen.

(viii) Another major problem had little to do with specific corporate lending experience. No one among the non-executive directors consistently applied an enquiring and critical approach to the activities of the board and senior management. Mr Rawlins did so for part of the period between the stock market crash in October 1987 and his resignation in April 1988. After that, there was little similar conduct to be noted, apart from concern expressed by Mr Moyle from time to time about capital adequacy, and rather belated
concern expressed by Mr Ryan about lending policies. This criticism, of course, goes to the wider issues of personality, motivation and thoroughness, rather than formal corporate lending qualifications.

(ix) There was an area, however, in which the lack of corporate lending experience by a number of directors became of great significance, because of the way in which the directors chose to perform their task. The round robin system, used by directors to approve credit submissions above $6.5m, meant that the non-executive directors were called upon to perform individually a vital executive task for which they were not fully qualified, with the exception of Mr Moyle and Mr Ryan. The task required a very active and knowledgeable involvement, but the directors went about it in an essentially non-executive manner, and for the most part did so without assistance. They were deprived of the necessary mutual support that would have been available had they acted on a collective basis. The later 'formal confirmation' process was not enough to compensate for the initial weakness of the system.

C. Directors' Perceptions of their Roles

(a) Neil Smith

15.16 Mr Smith's perception of his role at Tricontinental needs to be placed in the context of his other activities. When he was appointed to the SBV board in 1982, and the Tricontinental board in 1983, he had long since established a distinguished reputation as a skilled and experienced executive and chairman, in both the private and public sectors of the community.

15.17 After his retirement as the chief executive officer and full-time chairman of the Gas and Fuel Corporation of Victoria in 1983, Smith continued to be an extremely involved 'part-time' chairman of that organization, spending at least 40 hours per week on its affairs. Further, in 1983 he became chairman of the Bush Fire Appeal Trust, which distributed $27m in relief
to victims of the devastating bushfires of that year. In 1984 he became chairman of TAA, or Australian Airlines as it is now known.

15.18 Up to December 1985 Smith devoted relatively little of his activity to Tricontinental. In July 1985 he suffered a serious illness which required a number of weeks in hospital for coronary care. It is hardly surprising that in 1991 he remembered little of the details of his service at Tricontinental before 1986.

15.19 In December 1985 Mr Hancock, as chairman of SBV, suggested to Smith that he should retire as a director of Associated Midland Limited, a finance subsidiary of SBV based in Sydney, so as to avoid the strain of regular travel to Sydney, and instead become chairman of Tricontinental upon the re-arrangement of the board in January 1986. Hancock might well have thought that the appointment would only be for a relatively short time until the sale of Tricontinental, for that certainly became Smith’s view.

15.20 After accepting appointment as chairman of Tricontinental, Smith continued to be chairman of the Gas and Fuel Corporation until 1990, and chairman of TAA until October 1987. In 1988 he travelled frequently to Brisbane as Commissioner for Victoria at Expo ’88. At about that time he led a trade mission to China for three or four weeks. All this was accomplished despite short periods in hospital for coronary care in 1987, 1988 and 1989.

15.21 As chairman of Tricontinental, Smith in fact had a number of important functions to perform: to manage board meetings, promote good working relationships among directors and between directors and management, to lead the board in its tasks of formulating policy and monitoring corporate performance, and to act as a counter-balance to the authority of the managing director.
15.22 Smith did not regard it as his function to report on Tricontinental affairs to the SBV board, despite his position as chairman of the former, and deputy chairman of the latter. There was no requirement to that effect made of him by Hancock, but he was aware of such a requirement imposed upon Moyle. Smith did not in fact report except perhaps on an odd occasion if Moyle was not available. In later years Carr would report if Moyle was not available.

15.23 Smith said in evidence that his role was to see that the Tricontinental board worked effectively and that all directors were encouraged to express their views and opinions on matters that were relevant to the operations and performance of the company. He expressed regret that, owing to his other business commitments and his growing belief that at the proper time SBV would sell Tricontinental, he did not apply himself to learn more about the practices of merchant banking. He had believed that his appointment might prove to be short term.

15.24 He stated that, as chairman of an organization:

"I regarded it as one of my prime functions to ensure that top management was in place, and having put them in place, and accepting their performance as satisfactory, I think you are, in turn, entitled to rely upon them to perform."

In reply to counsel, Smith agreed that he regarded Johns as top management, and his performance as satisfactory.

15.25 Smith did not think he ever came to grips with the operational side of Tricontinental. That was a matter, as far as he was concerned, for the managing director. At no time would Smith have ever felt himself capable of being the managing director of Tricontinental. Naturally, he took no part in the day-to-day running of the company, did not attend meetings between the managing director and clients, and did not attend management meetings. He attended the offices of Tricontinental for board meetings and as his duties required.
15.26 The chairmanship of the Gas and Fuel Corporation continued to take the vast majority of Smith's time, and further time was spent on other activities as required. Smith said that, on average, he spent 15-20 minutes on each submission for extension of an existing loan facility, and half an hour on each submission for a new loan facility, although it might also have been necessary to look at a submission more than once, after perhaps having spoken to one of his colleagues about it. He said that he telephoned other directors in relation to approval of a loan submission approximately once a week.

15.27 Johns considered that Smith's capacity as a merchant banker was very limited, but that he had vast experience as a commercial businessman. Johns described their relationship as very open and friendly, and said that from time to time they chatted about all sorts of issues.

15.28 Smith agreed that Johns, because of his capacity and personality, was a very dominant figure at Tricontinental amongst the staff, more so than one would normally find with a chief executive. It appeared to Smith that Johns set a very high standard of performance for himself, and apparently demanded the same from his executive staff. Smith thought that Johns refused to acknowledge that other people may not necessarily have the natural ability to reach his standards, and was prone to treat any shortcoming as a lack of commitment rather than a lack of talent.

15.29 Johns' behaviour at board meetings never caused Smith any concern. Smith agreed that there were discernible conflicts on occasions between Johns and Ryan. He disagreed that Johns tended to dominate board proceedings. According to Smith, Johns always answered any queries that were raised and provided any information that was sought. Smith never felt cause to doubt Johns' commercial judgment, and entertained no concerns as to his personal integrity. As noted in the chapter on Johns, at para 13.115, Smith and Johns enjoyed a good working relationship. Upon the evidence, Smith
never crossed swords with Johns - it seems that he never saw any reason to do so.

15.30 The Commission makes the following findings about Mr Smith:

(i) He had a very limited view of the requirements of his role as chairman of Tricontinental, and the amount of time and attention needed for proper performance.


(iii) Mr Smith readily concedes that he knew little about merchant banking. He had great confidence in Mr Johns as the chief executive officer of Tricontinental, and he took very considerable comfort from having Mr Moyle, the chief executive officer of SBV, on the board (especially as he was highly regarded as a merchant banker). He was content to leave it to Mr Moyle to report to the SBV board about the affairs of Tricontinental. Mr Smith was also influenced by the potential short-term nature of his appointment, if Tricontinental were sold off by SBV. In his view, the circumstances did not warrant spending more time and effort learning about merchant banking.

(iv) Mr Smith's approach to his role as chairman of Tricontinental really amounted to running a relatively smooth board meeting, taking credit submissions home to read and assess to the best of his non-banking ability, and entrusting the rest to the experts.

(v) This approach could have worked, at least in the short term, in an enterprise that was blessed with well chosen policies, top class chief executive and senior managers, an appropriate organizational structure, effective operating systems, and skilled staff all doing their jobs properly. Unfortunately, that is not a description of Tricontinental from 1986 to 1989.
(vi) Mr Smith's idea of his role fell well short of what was needed from him in the circumstances, and this attitude was reflected in his performance.

(b) Jack Ryan

15.31 Mr Ryan did not profess to be a merchant banker, but he had extensive banking experience at SBV, including the activities referred to below, which demonstrate a significant degree of exposure to merchant banking before his appointment as a director of Tricontinental.

15.32 From September 1976 until May 1978, Ryan was seconded as the managing director of Westralian Holdings Limited which, through its subsidiary Westralian International, conducted the merchant banking operations described in para 7.6 of the first report. He acted in a trouble-shooting role, seeking to resolve difficulties that had arisen.

15.33 While so engaged, Ryan was approached by Mr Redenbach, who proposed a merger between Westralian and the then Tricontinental. During 1978 Ryan participated in discussions and the preparation of a memorandum to SBV outlining the advantages of a merger. Subsequently a 'new' Tricontinental was formed. It brought together a consortium of banks as owners, including SBV (see first report, paras 7.1 to 7.15).

15.34 After returning to SBV in May 1978, Ryan's tasks included the establishment of a corporate lending division. In 1984 he acted as chief executive officer of SBV, pending the appointment of Mr Moyle.

15.35 Upon Redenbach's resignation as managing director of Tricontinental in 1985, Ryan was seconded to take his place, initially for a period of three months. He started in April, but remained after the three months expired in order to negotiate a price for SBV's purchase of the interests of outgoing
shareholders in Tricontinental. He then stayed on until December 1985, to enable SBV to find a replacement managing director.

15.36 In order to determine an appropriate price for Tricontinental, Ryan had to evaluate the assets. Along with members of the SBV board, he was mindful of the possible problems identified by Touche Ross & Co. in its report to Mitsui; see paragraph 9.13-23 of the first report.

15.37 Ryan carried out what was described by Moyle as a "thorough review" of the loan portfolio. The result led to a decision to increase the provision for contingencies from $8m to $12m, and to set a price equivalent to net tangible assets less 25%.

15.38 Ryan's attitude to Tricontinental's loan portfolio, and the business of merchant banking, was expressed as follows:

"At that time (1985) the loan portfolio of Tricontinental was a good one for a merchant bank. One would not expect to find the quality of a merchant bank's loan portfolio to be of the same standard of that of the SBV."

15.39 While seconded to Tricontinental, Ryan had ample opportunity to observe the nature of the business, the operation of the systems in place, and the quality of the staff. He gave the following evidence:

"... having the opportunity of being able to assess people and the systems and being able to move around the interstate offices probably gives you the opportunity to make as good, if not better, assessment than anybody just sent in to do a due diligence" (first report, para 9.57).

15.40 Ryan retired from SBV in July 1985, while still acting managing director of Tricontinental. When he ceased to hold the latter appointment at the end of 1985, he was exceptionally well placed in terms of experience, knowledge and availability to be a diligent and well-informed non-executive director of the corporation. He was so appointed from January 1986.
Having retired from SBV, Ryan made a practice of calling in to the Tricontinental office on two or three days of most weeks during 1986. He said he would wander around and talk to the people to get a better understanding of how things were going, but he did not go back through files. During that time he would speak to Hunter, Stott, Mountford, Maddison and Clark. He said that he talked to them about submissions and whether they had any concerns.

Mr Mountford described Ryan as the "linchpin" amongst non-executive directors in the round robin process. On the other hand, Mr Stott was not aware of any such pivotal role. Mountford often received responses from directors about loan approvals in the six months before May 1989, due to Johns being interstate. It was his impression during that time that other directors were interested in knowing whether Ryan had approved a submission.

As already noted in chapter 13, Johns said that he regarded himself as being "on P plates" for the first twelve months of his term as managing director. He had regular meetings with Ryan, who gave freely of his time and advice. These meetings were held on a weekly basis and usually lasted about half an hour to an hour. Both general policy issues and specific transactions were discussed. Ryan had been directly involved in the appointment of Johns as his successor. He had formed a favourable view of Johns, and had provided advice to Moyle in support of the appointment.

However, there came a time when Ryan was chided by Johns for constantly looking over his shoulder. Ryan backed away to some extent, although he continued to visit the office regularly in order to look at credit submissions. Ryan said that he and Johns continued to converse fairly often about matters of current interest, but Johns said that after this time, if he needed to talk to a director, it would normally be either Smith or Moyle.
Ryan believed that, from the beginning, Johns resented board interference. According to Ryan, Johns considered that he should be fully in control and believed he had the capacity to run the business virtually by himself. After Johns won the ‘Young Executive Of The Year’ award in 1986, Ryan detected a change in Johns’ attitude. “He became much more arrogant and strong-minded. He seemed to regard himself as virtually infallible.”

Johns said he had no view of Ryan’s ability as a banker from a retail commercial point of view. He thought Ryan’s ability as a merchant banker was limited, but that he was keen to learn, and "kept his ear and nose close to the ground" so as to know what was going on.

Ryan said that, after the stock market crash of October 1987, he had a growing "gut feeling" that the listing of doubtful debts provided to the board did not reveal the true position. He pressed Johns harder and harder at board meetings about the accuracy of his forecasts, and there were some "violent" arguments. Johns resented persistent questioning by both Ryan and Rawlins, but according to Ryan, always had what seemed to be a satisfactory answer. Ryan said that Johns had a very good track record of recovering loans, and the board was generally inclined to accept his assurances, as they seemed to be soundly based. Ryan had not believed that information was ever deliberately withheld from the board by management. At the board meeting held on 22 December 1988 Ryan declined to approve loan facilities to Centaur ($72m) and Dallhold ($100m), but he received no support and they were approved by majority decision.

Ryan agreed in evidence that it was an unusual situation for Johns, as managing director, to continue to be so involved with loan accounts from 1986 up to 1989. It was abnormal for clients to continue to deal with Johns exclusively, as they had done before Johns became managing director.
In early 1989 Ryan considered that Johns' discretion to approve loans up to $6m was excessive, and that the limit should be reduced. Moyle considered that the lending delegation was satisfactory, and this was the view of the other directors. Ryan said words to the effect: "If that's the view of the shareholder (SBV), then I won't raise any further questions now. But if there is any change of shareholder and I am still on the board, I will raise this issue again at the next meeting." It is interesting to note, however, that Mr McAnany considered that the level of Johns' discretion, in itself, was not inappropriate.

The Commission makes the following findings about Mr Ryan:

(i) Mr Ryan was willing and available to perform fully the tasks of a non-executive director of Tricontinental. Any problem lay not in his perception of the role, or in his general qualifications, but in his actual performance.

(ii) Mr Ryan was well equipped to monitor Tricontinental's objectives and performance. He did not have the equivalent of Mr Moyle's skill and background in merchant banking, but more than any other non-executive director, he knew how Tricontinental worked from the inside. For nine months in 1985 he was chief executive officer. During 1986 he continued to visit the Tricontinental office regularly, and conversed extensively with Johns and the senior managers. Frequent visits continued after that year.

(iii) In the process of approving credit submissions, approval by Mr Ryan seems to have carried weight with other directors. This was probably due to his general banking experience, his 'hands-on' experience at Tricontinental, and the fact that in his retirement he had sufficient time to study submissions closely and talk to senior managers.

(iv) As a witness before the Commission, Mr Ryan gave the impression of a man with a realistic view of the world, and one who would
have had a healthy distrust of anybody who thought that boom times would never end.

(v) That being so, one of the puzzling questions in this inquiry is why it took Mr Ryan so long to get to the point of making an appeal to the board to reassess its credit policy and to adopt a more conservative approach to lending, as he did, so urgently, in April 1989 (see first report, para 16.33).

15.51 Bill Moyle

Mr Moyle's perception of his role as a director of Tricontinental was that of a non-executive director. He stated:

"I had no executive responsibilities for Tricontinental and the managing director of Tricontinental did not report to me as chief executive officer of SBV ... While there was commonality of directors between Tricontinental and SBV, this did not affect the point that Tricontinental was managed independently and autonomously."

15.52 In evidence, Moyle explained his position in the following terms:

"I was very conscious of the fact that I was there as an external director of Tricontinental, not as a manager of Tricontinental, and so I therefore tried hard not to step over the line of confusing the two roles while I was acting as a director of Tricontinental ... I would make it quite clear when I was speaking for established SBV board decisions or policies. That wasn't often the case, but my colleagues who were on both boards were aware that I was expressing personal views rather than State Bank board determined views. There were very few occasions indeed when State Bank board determined views were expressed by me at the Tricontinental board."

15.53 He said that he saw himself as representing the interests of the shareholder along with the other directors, and he was filling that role rather than acting as a specific watch dog. Moyle conceded that where the chief executive officer of the sole shareholder is a member of the board of a subordinate company, he is likely to play an important role.
15.54 As chief executive officer of SBV, Moyle was perceived by all other directors of Tricontinental, including the chairman, as being well qualified to make decisions about Tricontinental and to assess Johns' proposals, and in evidence they expressed their heavy reliance upon him. Although Moyle had no executive responsibilities within Tricontinental, and the chief executive of Tricontinental did not formally report to him, nevertheless he was the means by which reports were presented to the SBV board on the key performance results of Tricontinental. Johns said that Moyle would take a set of Tricontinental board papers away from meetings, presumably for use in preparing reports to SBV, and for general reference purposes.

15.55 Johns, like the other directors, said that he relied heavily upon Moyle's experience. He viewed Moyle as a very experienced merchant banker, and said that he spent more time talking to Moyle than to any other director. Possibly this comment overlooked the extent of his discussions with Ryan in 1986.

15.56 Moyle agreed that it was a considerable strain to be the chief executive of the parent company, but not have authority over the chief executive of a subsidiary company, as this diminished his ability to grapple with the subsidiary. The decision by the SBV board to grant operational autonomy to Tricontinental required Moyle not to involve himself in management, to remind himself that Tricontinental was managed independently and autonomously, and to concentrate on his role as an external director. It is noted, however, that requests by Moyle from time to time for papers to be presented to the board were readily met.

15.57 Moyle gave evidence that he was unaware that Johns, whilst managing director, controlled 70% of the loans (by value). He noted this would be a very high percentage, over the $2 billion mark. He did not know how many customers that would represent, but estimated between 60 and 70.
He regarded Johns as a very hard worker, but found it difficult to reconcile that level of lending control with proper performance of the responsibilities of chief executive officer.

Moyle could not recall any occasion on which he was aware that Johns was telling him an untruth, or was misleading or deceiving him. He agreed that Johns' judgment carried a lot of weight around the Tricontinental board table.

Johns gave evidence of the high regard he had for Moyle. He said "There was never any formal reporting lines between myself and Bill Moyle, but I always considered informally that I did report to Bill Moyle. At board meetings, if there was ever a matter on the table which some of the directors weren't sure of, they would always turn to Moyle for his opinion ..." Later in his evidence he described Moyle as "a very experienced banker, very experienced ... as a merchant banker [with] a great wealth of knowledge." He also said, "... I did spend more time talking to Bill than other directors. ... when he did want something I jumped to it. ... He was a lot older than I was, and had a lot more experience than I had. He was very well connected in the industry."

The Commission makes the following findings about Mr Moyle:

(i) Mr Moyle, understandably and correctly, considered himself to be in a difficult position as a result of the way in which the Tricontinental board was constituted from January 1986.

(ii) He had favoured the appointment of an SBV executive board for Tricontinental, with himself as chairman and other key SBV divisional heads, together with Johns and Ryan, as members. What Mr Moyle had in mind was that reporting lines would have flowed through him as chairman of Tricontinental to the board of SBV, and that SBV divisional heads, in their roles as directors of Tricontinental, would have been able to exercise direct control over
the relevant functional areas of Tricontinental (first report, para 9.97).

(iii) On the other hand, the chairman of SBV, Mr Hancock, considered that autonomous operation by Tricontinental was necessary because of the very different cultures of Tricontinental and SBV, and because SBV wanted to ensure that it would be able to dispose of Tricontinental at some future time (first report, para 9.89). Moyle deferred to Hancock's view.

(iv) The result of the arrangements instituted in January 1986 was that Mr Moyle had no direct responsibility for the conduct of Tricontinental's affairs; and more importantly Mr Johns, as chief executive officer of the subsidiary corporation, did not report to the chief executive officer of the parent corporation.

(v) However, Mr Moyle could not escape the heavy reliance placed upon his views by all other directors, and he was well aware of the very real influence that he wielded.

(vi) More than anyone else on the Tricontinental board, including Mr Johns, Mr Moyle was in a position to appreciate where Tricontinental was heading. With his skills and experience he was best placed to appreciate the appropriateness of Tricontinental's corporate strategy, its organizational structure and operating systems, and the standard of performance by staff, senior managers, and the chief executive officer.

(vii) Most importantly, he was well placed to initiate remedial action, if any of these matters needed it. It is unlikely that the Tricontinental board, including Mr Johns, could have resisted any well-justified argument presented by Mr Moyle. It is also probable that Moyle could have persuaded the SBV board to intervene, through the directors common to SBV and Tricontinental, to rectify any serious problem in the conduct of Tricontinental's affairs. Respecting the autonomy of a subsidiary was one thing. The protection of SBV from exposure to grave financial risk was quite another, and much
more important.

(viii) For the reasons apparent elsewhere in this report, the inferences are irresistible that either Mr Moyle was well content with the way Mr Johns was running Tricontinental’s operations, or if he was not, then he was not prepared to do much about it. In fact, in most respects Moyle was very supportive of Johns. He went so far as to nominate him for a ‘Young Executive of the Year’ award in 1986 (first report, para 11.36).

(ix) One matter to be borne in mind is the probability that Mr Moyle was influenced by the need to build up Tricontinental for sale or float and, when difficulties started to emerge in the conduct of Tricontinental’s affairs, he would have been reluctant to do anything that might prejudice a profitable disposal of Tricontinental in the near future.

(x) Thus he would have been reluctant to do anything that would cause Mr Johns to resign, or would be seen to undermine Johns’ authority, as he was widely regarded as the driving force behind Tricontinental’s apparent success.

(xi) The probability of Mr Moyle being influenced in this way is illustrated by the weakness of his response to the requests for change made by Mr Rawlins.

(d) John Rawlins

15.61 At about the time SBV gained control of Tricontinental, Moyle suggested to Mr Rawlins that he should become a director of Tricontinental. Moyle saw ways of obtaining benefits for SBV by integrating the treasury divisions of Tricontinental and SBV. Rawlins was asked to devise a merger of the two divisions, with a view to obtaining a common funding pool, economies of scale and cheaper funding for Tricontinental. Rawlins noted, however, that the proposal was resisted by Tricontinental on the grounds that, as it was a separate funding centre, it was appropriate for it to be in charge of its own liability management. Johns made it clear that
he wished Tricontinental to remain master of its own destiny and retain control over a source of its profits. Ultimately the proposal was dropped.

15.62 Although Rawlins had a strong background in money market operations and treasury functions, including experience with a merchant bank (Australian United Corporation), at the time of his appointment as a director of Tricontinental he did not have any significant experience in corporate lending. Rawlins made frequent contributions to board discussions in his areas of expertise, and in evidence his fellow directors confirmed that he was well regarded for that expertise.

15.63 Rawlins' background as a sharebroker qualified him to appreciate one particular aspect of Tricontinental's lending. That was the significance of Tricontinental's lending secured by shares. Rawlins' evidence bears this out. In his statement to the Commission Rawlins referred to his "principal concern ... with the quality and enforcement of equities given as security", and that after the October 1987 stock market crash he had "expressed concern during board meetings at the quality of equities that were being given as security for loans. Johns disagreed with me and appeared to resent requests for information."

15.64 Rawlins' background as a sharebroker also qualified him to appreciate the significance of another aspect of Tricontinental's business - those investment banking transactions in which Tricontinental purchased shares in its own name, but had arrangements with clients for put and call options over those shares. However, Rawlins rejected a suggestion by counsel that this placed a particular responsibility upon him.

15.65 Johns believed that Rawlins was aware that he (Johns) was not very familiar with the money market aspects of Tricontinental's business, and that Rawlins was quick to point out his deficiencies at board meetings. However Rawlins' concern went wider than money market matters. He
thought that Johns was too autocratic, and did not willingly provide the
board with information to which it was entitled. Rawlins, and later Ryan,
became persistent questioners. In effect, Ryan took up the running after
Rawlins resigned.

15.66 Clashes between Rawlins and Johns led to Rawlins' resignation from the
board in April 1988. The matter is discussed in detail in paras 18.45 to
18.67 of the first report, and also para 13.118 of this report.

15.67 Minutes for the board meeting in December 1987 record that Rawlins
raised queries concerning the acceptance of mining leases as security, the
maintenance of the value of equities as security, the expansion of
Tricontinental's funds management business, the contents of a paper
regarding liability management, delegation of approval of lending facilities,
and material changes to existing facilities without the (further) approval of
directors. This was a perceptive list of probing questions.

15.68 Rawlins could not attend the meeting in January 1988, but minutes for the
February meeting record that he then "raised his concerns with
management's cavalier attitude to doubtful debts as the board was not
always fully informed". Minutes for the March meeting record that
Rawlins declined to approve two loan facilities.

15.69 Some days after the March 1988 board meeting Rawlins spoke to Moyle
and told him that unless Johns' powers were restricted he would resign.
As Moyle was unwilling to try to restrict Johns' powers, Rawlins resigned
by letter dated 21 April 1988. It is interesting that Rawlins went to Moyle
with his complaint, and did not discuss it with Smith.

15.70 In evidence given before publication of the first report, Rawlins said that
his resignation involved two elements. They were his dissatisfaction with
information being provided to the board, and his concern regarding the
attitude displayed by Johns towards the board. It is curious that board members, other than Moyle, say that they were unaware of the true circumstances behind Rawlins’ resignation - not even Johns himself or chairman Smith admitted to knowing the reason. The general perception was that Rawlins had resigned in order to join the board of Burdett Buckeridge & Young. That event certainly followed the resignation, but was not the real reason for it.

15.71 When recalled to give evidence after the publication of the first report, Rawlins was asked whether he had any comment to make in relation to the description of the circumstances of his resignation contained in the report. In response, he expressly denied the suggestion by some directors that his departure from Tricontinental was for the purpose of joining the board of directors of Burdett Buckeridge & Young. He said:

"My clear recollection is that the BBY issue was coming to a head round about January 1988, and although it had not been approved by the State Bank board I was clearly of the view that I was expected to go to that BBY board, and that it was not a question of re-organisation at all, that I resigned because I felt that Mr Johns was not giving us adequate information, and that I did not want to stay on a board when I felt that I could not get answers that I required from the managing director."

The weakness of Moyle's response to Rawlins' request, and the consequences of Rawlins' departure, are noted in para 13.118 of this report.

15.72 The Commission makes the following finding about Mr Rawlins:

(i) Mr Rawlins brought to the board a strong background in money market operations and treasury functions. It appears that he played an active role in those areas at board level, and was respected by his fellow directors for it, although Mr Johns seems to have felt some discomfort at any exposure by Rawlins of Johns' lack of expertise in those areas.
Following the stock market crash of October 1987, Mr Rawlins felt uneasy about a number of important matters, and particularly the quality of shares held as security for many loans. This is not surprising, given his background as a stockbroker. He was not satisfied with the information being given to the board, nor was he satisfied with Mr Johns' attitude to the board. This led to the comment to the board about "management's cavalier attitude to doubtful debts".

Mr Rawlins obviously felt strongly about the obligation of the chief executive to keep the board properly informed, to the point where he "did not want to stay on a board when I felt that I could not get answers that I required from the managing director".

It is significant that Mr Rawlins turned to Mr Moyle alone, and not to Mr Smith, in his search for support. It is also significant that Moyle, on the evidence, did not speak to Johns, Smith, or any other Tricontinental director about Rawlins' complaint.

It seems unfortunate that Mr Rawlins did not continue to press his objections formally at the Tricontinental board, so as to force a response, one way or the other. No doubt he felt somewhat inhibited by the presence and attitude of Mr Moyle, his chief executive officer at SBV.

It seems that Mr Ryan took up the running to some extent after Mr Rawlins' departure, and more particularly after a revelation in June 1988 relating to the Mainsel transaction. Mr Ryan said in evidence that from that time he "quizzed Johns a lot more at board meetings".

It is clear however that, with the resignation of Mr Rawlins in April 1988, Mr Johns escaped any further examination by his most persistent critic.
Max Carr

15.73 Although Mr Carr had no merchant banking background, he considered that his long experience in various areas of banking was adequate for the task of approving Tricontinental's credit submissions, and was complementary to the experience of the other directors. Between them, the board had a sufficient spread of expertise.

15.74 Carr had exposure to Tricontinental well before his appointment to the board in April 1988 following the resignation of Rawlins. In September 1985 he was appointed as alternate to Moyle, although this seems to have been forgotten, for he was again appointed as alternate to Moyle in June 1986. In the meantime he was appointed alternate to Mr Lewin from November 1985 to April 1986, and attended six board meetings in that capacity.

15.75 Carr said that, as an alternate, he was very much an observer at board meetings, and did not recall ever having been asked to raise a specific issue by Lewin or Moyle. Of considerably greater importance is that, in his capacity as an alternate to Moyle, Carr approved a large number of credit submissions. The significance of this is referred to later in this chapter.

15.76 Upon appointment to the Tricontinental board in his own right in April 1988, Carr regarded himself as a representative of SBV. He was told by Moyle that SBV wished to continue to develop the business of Tricontinental. Moyle expressed the view that Carr would be able to get along with Johns. Carr was aware that Rawlins had had differences of opinion with Johns.

15.77 Carr said that he saw Johns as the dominant person at Tricontinental. He said that this was one of Johns' strengths in a number of respects, but he believed that Johns acknowledged that in the end he had to take direction from the board. Carr sensed at times that Johns did not like this fact, but
he accepted it. Carr said that he did not believe Tricontinental was a one man band, referring to the dominance by Johns.

15.78 He did not agree that there had been a lack of effective checks and balances over Johns' lending decisions, but he acknowledged there were points made in the evidence to the Commission of which he had not been aware at the time, which now made him question his belief.

15.79 Carr did not feel that Johns or any other director exerted pressure on him in respect of any loan submission or application for finance.

15.80 The Commission makes the following findings about Mr Carr:

(i) Mr Carr brought no experience in merchant banking matters to the Tricontinental board, in contrast to Moyle, Ryan and Rawlins.

(ii) However, Mr Carr did have a long experience in general banking, and particularly in banking administration. He was adequately equipped to make a useful contribution to the Tricontinental board, if that were done in conjunction with the skills of the other directors.

(iii) Mr Carr considered that his skills and experience were adequate for the task of approving Tricontinental's credit submissions. On the face of it, that should have followed from his membership of the SBV credit committee since about September 1985. However, there is one qualification that should be made. The round robin system for approvals by Tricontinental directors had a strong tendency to promote decision-making by directors in isolation from each other, so that defects that ought to be plain to an experienced merchant banker might be missed by a traditional banker working alone. Of course, if a defect was so obvious that it ought to be apparent to any director with reasonable banking, financial or accounting skills, then that qualification would lose its force.
(iv) As shown later in this chapter, Mr Carr played a major role in the round robin system, but he must be regarded as one of the weaker links in it. Only Mr Smith was clearly in a weaker position to make informed judgments. Mr Morton, through his role on the SBV credit committee, and his long financial experience elsewhere, probably had relevant experience at least equal to that of Carr. Mr Carr could not recall having rejected any credit application during his period as an alternate to Mr Moyle. It seems however, that he did become more critical as time went on, because towards the end he was joining Mr Ryan in querying whether particular approvals should be given. Unfortunately the difference between them was that, by then, Mr Ryan sometimes maintained his refusal, whereas Mr Carr could usually be persuaded to change his mind. No doubt, like Mr Rawlins, he was generally influenced by the presence and attitude of Mr Moyle, to whom he was a loyal lieutenant.

(f) Ian Morton

15.81 Mr Morton, already a commissioner of SBV, became a director of Tricontinental at the request of Mr Hancock, chairman of SBV. Morton replaced Hancock on the Tricontinental board when Mr Smith became chairman.

15.82 Morton's previous experience as a director of a finance institution, apart from his role as a commissioner of SBV, had been as full-time chairman of the Rural Finance and Settlement Commission. From January 1985, Morton continued as part-time chairman of the Rural Finance Commission. He described his experience with that Commission as involving the lending of money:

"Essentially to farmers and industry outside the metropolitan area. By far the larger proportion of the book was to farmers. The association with secondary industry was to do with the establishment of industry under what was then called decentralisation programs, and also the management, if you like, or even the rescue of processors or particular key industries within country districts that
were in difficulty and it was necessary for a third party, if you like, to come in with a capacity to reach for the cheque book if one needed it, to keep those industries in business.*

15.83 During his period as a Tricontinental director, Morton distributed his time between four principal pursuits - SBV (director and member of the credit committee), Rural Finance Commission (chairman), Victorian Economic Development Corporation from October 1988 (chairman), and Tricontinental. He said that, if he had thought that he could not meet his responsibilities, he would have resigned.

15.84 Morton did not become involved in the approval of credit submissions immediately upon becoming a Tricontinental director. He preferred to learn more about the business first. He did this by giving particular attention to board papers. After some months he started to become involved with the submissions, and at that stage (May 1986) also became a member of the accounts and audit committee.

15.85 In response to Stott’s evidence that he was advised that Morton would prefer that credit submissions not be sent to him in the normal process, Morton said that he did not inform Stott or anyone else in those terms. He regarded Stott’s evidence as unfair, but the fact remains that he was called upon much less often than the other directors (except Ziebell who was hardly ever used).

15.86 Morton explained his perception of the relationship between SBV and Tricontinental as involving the continuation of Tricontinental as a separate legal entity, since he believed that the two organisations were so different as to preclude the possibility of integration. Nevertheless, Morton had the view that SBV could impose ultimate control over Tricontinental.

15.87 Johns impressed Morton with his knowledge of the operations of Tricontinental. Morton said that he always felt Johns had a complete
knowledge of the operations, and gave adequate explanations on any issue that was asked of him by members of the board. Morton found Johns a difficult person to warm to socially, but felt this didn't impact on his professional competence.

15.88 Morton said he did not agree that Johns tended to dominate proceedings at the board.

15.89 Morton recalled that, within about six months of joining the board of Tricontinental, the consideration of non-performing loans was moved to one of the first items on the agenda, to allow sufficient time for discussion. There was always a full and healthy discussion about the problem loans. He stated that he had no cause to believe that the information provided to the board was in any way deficient. Johns demonstrated that he had an unusually high capacity to work his way through difficult loans.

15.90 Johns' view of Morton as a merchant banker was that his experience was limited. Johns noted that Morton did get heavily involved when Tricontinental was looking at the meat industry.

15.91 The Commission makes the following findings about Mr Morton:

(i) Mr Morton's long experience in financial institutions, including membership of the SBV board since 1971, and the SBV credit committee since 1985, qualified him to bring a range of relevant skills to the Tricontinental board. Mr Renard spoke highly of Mr Morton's value as a member of the SBV board. He was cautious, experienced, and could listen, say little, but then put his finger right on the vital point.

(ii) As mentioned, Mr Morton was less involved than any other director, except Mr Ziebell, in the approval of credit submissions. In this connection, it must be remembered that he was very busy
with his commitments elsewhere throughout the period of his directorship at Tricontinental.

(iii) Given Mr Renard's description of Mr Morton, which the Commission has no reason to doubt, it is puzzling that he did not speak out at an early stage, or indeed at any stage, against the more obvious defects in Tricontinental's policies and practices.

(iv) Whatever the full explanation, there were at least two considerations. First, he was busy, and not likely to have focused deeply on Tricontinental's affairs unless actually at the board table of Tricontinental or SBV. There are some parallels with Mr Smith in this regard. Secondly, he accepted Mr Johns as a competent chief executive, was impressed by his knowledge, and was satisfied with the explanations given at board meetings.

(v) As a witness, Morton impressed as a knowledgeable, courteous but shrewd person. It seems, however, that he was too ready to accept Johns at face value, and too slow to be critical of his explanations.

15.92  
(g) Bruce Ziebell

In his capacity as executive director, general manager administration and company secretary, Mr Ziebell's responsibilities included the following functions:

- Accounting, including preparation of statutory accounts. The general manager accounting reported directly to Ziebell.
- Taxation affairs, including taxation planning (with assistance of outside consultants).
- Legal affairs, including those related to Tricontinental's investment banking activities.
- Most information systems, including computerised electronic data processing.
- Personnel, economists, library, insurance.
- Tricontinental Futures Pty Ltd and, until late 1988, the funds management business conducted under the name of "Multitrust".
In all, the administration division employed more than 40% of Tricontinental’s total staff.

As company secretary, Ziebell attended almost all meetings of the Tricontinental board of directors between February 1982 and May 1989. He was responsible for compilation and circulation of agenda for board meetings, and for recording and preparing minutes of the meetings. He also attended meetings of the audit and accounting committee, although he was not a member of that committee, and was responsible for preparing agenda and minutes. Ziebell was the initial point of contact between Tricontinental and its auditors. He was also a member of Tricontinental’s management committee, and was responsible for preparing agenda and minutes.

Ziebell was the longest serving member of Tricontinental’s management team. Having ‘grown up’ with the Melbourne office, he was well placed to be familiar with the internal operating systems of Tricontinental. However, he had never worked on lending procedures or guidelines, corporate targets or marketing, and did not assess loan transactions. Shortly after appointment as a director Ziebell was told bluntly by Johns to keep out of the lending area. He willingly did so. He said that he "had no responsibility for lending practices and procedures in any capacity". He read the guidelines relating to matters not within his areas of responsibility and tried to become familiar with them. He did not read the internal reviews of Tricontinental’s clients that were presented to the board.

Ziebell said that he did not think that Johns was sufficiently experienced for the job when he was appointed managing director, but he was impressed by his commitment, and his honesty. He never felt that Johns was incompetent as managing director, or obviously lacking in expertise. He considered that Johns was clearly competent in the lending area. Ziebell thought that Johns was street-wise, tough, and paid a lot of attention to detail. Johns regarded lending as his domain, and would not tolerate interference in that area.
Ziebell said he was aware that up to May 1989 Johns initiated a lot of the lending activity, but he (Ziebell) had been under the impression that the matters went back into the system and were delegated through the lending area. Ziebell hadn’t realized that Johns retained so much "hands-on" control of the activity.

Ziebell said that he did not believe it was a healthy situation that Johns had relationships of a personal nature with a number of business clients.

According to Ziebell, Johns had a gruff exterior, could be very aggressive, arrogant, bad tempered, or extremely generous. He jealously guarded his privacy.

Everything with Johns seemed to be urgent. Ziebell suggested that often a matter was not as urgent as Johns made out, but he seemed to generate that kind of pressure.

Johns and Ziebell each stated that they worked very closely together. They presented a united front to staff. Any disagreements were argued out in private. Johns was critical of Ziebell from time to time for recording only the results of board discussions in the minutes, instead of including reports of the actual discussions. However, Johns rarely changed the draft minutes prepared by Ziebell.

Ziebell touched upon a key point in the following passage of his statement:

"(Johns) was lucky to be lending when market conditions were on the rise. The test of a good manager is to ensure that appropriate protections are in place for the time when the market turns down."

Later in evidence Ziebell referred to the same criterion as the test of a good board.
The Commission makes the following findings about Mr Ziebell:

(i) Mr Ziebell had a vital role in the general administration of Tricontinental.

(ii) He attended board meetings in the dual capacity of executive director and company secretary.

(iii) At board meetings he was, at least in a formal sense, a party to the formulation of policy, the approval of facilities and other matters that were dealt with originally at the board meeting itself, and the ratification of facilities approved previously under various delegated powers.

(iv) The evidence before the Commission shows that in his executive capacity Mr Ziebell implemented accounting practices, and devised tax-driven arrangements, that could not stand up to close examination. These are referred to elsewhere in this report.

(v) Mr Ziebell only rarely participated in the round robin process for the approval of credit submissions by directors. As noted previously, he was specifically warned off lending matters by Mr Johns. It is likely that, in fact, he was fully occupied with his other executive duties.

(vi) The substantial exclusion of Mr Ziebell, as a director, from the lending side of Tricontinental’s affairs seems to have been accepted by the other directors without comment.

D. Corporate Objectives And Policies

(a) Lending strategy

Financial deregulation brought many changes, including intensified competition between banks in the corporate lending market, particularly at the lower-risk end of that market. The changes caused many merchant banks to withdraw from or reduce their participation in corporate lending, and to concentrate their attention upon the provision of fee-based services.
Tricontinental, however, chose to continue its corporate lending activity, maintaining its focus on the higher-risk end of the market, where the competition from the major trading banks was not so intense, and the potential rewards were higher. Tricontinental was, of course, not alone among merchant banks in continuing to engage in corporate lending after deregulation.

Tricontinental's lending strategy involved two major aspects. One was the nature of Tricontinental's lending. That concerned the type of clients, the type of lending business to be transacted, and the terms and conditions to be included. The acid test of the nature of lending was whether there was likely to be due performance by the clients and, in the event that there was not, whether Tricontinental's position would be adequately protected.

The second aspect was the volume of Tricontinental's lending. That concerned the limits to the volume of lending over-all, and the limits to facilities granted to individual clients or client groups. Of course, the volume of lending affected the extent to which Tricontinental itself required access to funds in order to carry on its business.

These two closely related aspects of Tricontinental's lending strategy were to give rise to most of the problems that led to Tricontinental's collapse.

(b) The nature of Tricontinental's lending

In November 1984 a paper on Tricontinental's lending strategy was presented to the board by the then managing director, Redenbach, and by Johns, who was then the general manager lending. The strategy in place at that time had been developed over the preceding five years. The paper proposed that the same strategy should continue to be pursued vigorously in the future. Extracts from the paper are set out in the first report at para 8.18. Some parts are repeated or summarized below.
The paper stated that Tricontinental had "developed a lending market niche", in which Tricontinental had established a leading role as a lender to second or third ranking public companies, private companies and high net worth individuals. The higher risk was acknowledged, but margin returns were markedly better than elsewhere. Success had come from what was described as Tricontinental's ability to structure facilities correctly and to manage them professionally. The strategy was said to have resulted in a substantial track record of profitability with minimal risk and losses, despite a "major economic downturn".

In a significant passage, the paper stated:

"Due to Tricontinental's performance as a secured lender, we have been able to most substantially increase exposure levels to any one client, as the total risk element in a facility does not equate to the total amount of dollars advanced."

Even more significantly, the paper went on:

"It is agreed that there is always an element of risk in every facility, whether secured or unsecured. Our highly experienced and commercially successful assessment of security and the risk attached thereto in the event of a forced sale and our professional management of clients lending covenants etc. has ensconced Tricontinental as a market leader and accounts for a major degree towards its success."

The paper then proposed that a number of competitive steps be taken. These included:

- "establishment of credit limits for certain clients to demonstrate our recognition of their standing and to encourage long term, first opportunity relationships.
- maintain our concentration on private companies whose loyalty can be more predictably relied upon.
- emphasise our ability to access clients to senior people void of the bureaucratic processes which are characteristic of 'trading banks'.
- heavily market our flexibility on a lending package and quick turnaround in decisions.
- develop special loan products i.e. approval line of credit against share portfolios.
- provide specialised industry lending."
There is no suggestion in the board minutes that the directors in office at that time dissented in any way from the paper's assessment of present and future strategy. It is now possible to discern all the seeds of Tricontinental's later problems in this list.

At about the same time however, other changes were in the wind for Tricontinental. The combination of financial deregulation, relaxation of foreign investment guidelines, the increasing unworkability of a merchant banking consortium with numerous owners, and the benefits of majority ownership by a strong trading bank parent, all led Mitsui Bank Limited to offer, in November 1984, to buy out the interests of other shareholders. SBV would have been a willing seller. The recent freedom to develop into a full service bank made SBV's investment in Tricontinental "anachronistic", according to Mr Moyle (first report, para 9.7).

A report dated 8 February 1985 was prepared by Touche Ross & Co to assist Mitsui in its consideration of acquiring 100% ownership of Tricontinental. The report considered a number of matters about the state of Tricontinental's business. In the end, Mitsui decided not to proceed with the proposed acquisition. According to Moyle, Mitsui explained that its decision was based in the main on potential management problems. The matter of present relevance, however, is that some doubt about asset valuations had also been raised, and the review by Touche Ross made the following points about Tricontinental's loan portfolio:

- "Tricontinental has several major client groups whose loans constitute a major proportion of the Company's portfolio".
- "A significant amount of total loans is provided to the Jewish community and in loans for property development".
- "Information on loans, particularly those loans in arrears is not always completely documented on the files and significant reliance must be placed on senior staff".
There are a number of loans which have been in arrears for some time and which have not been closed because of concern that action may endanger the underlying security. 

(First report, para 9.21)

The Touche Ross report was made available to all Tricontinental directors, and it also became available to at least some SBV directors (first report, para 9.36(ii)). The substance of the report was discussed at the meeting of SBV commissioners on 26 March 1985, when they considered the options that were available following the withdrawal of Mitsui's proposal. At that meeting Mr Smith, who had also been a director of Tricontinental for nearly two years at the time, referred to the high loan exposures of Tricontinental relative to its capital base. He noted that a "couple" of loans of between $40m and $100m were included in the portfolio. He also raised the "frightening aspect" that if one of these major loans failed, Tricontinental would be in a "negative situation" - that is, its liabilities would exceed its assets. Although Tricontinental's portfolio was secured, it was "difficult to ascertain the nature" of that security (first report, para 9.36(v)).

At a later SBV meeting, on 11 July 1985, Moyle presented a memorandum recommending that SBV formally offer to acquire the interests of the other Tricontinental shareholders. The memorandum included the following comments on the state of the loan portfolio:

"The quality of assets has been of some concern. However, a thorough review of the asset portfolio has been undertaken. All non-performing accounts have been reviewed. Estimated losses on existing loans are approximately $8 million, just within the existing provision for loss. The proposed price discount is considered to fully protect SBV against any potential for loss arising from this or other factors."

(First report, para 9.41)

The price discount adopted was 25% off the estimated net tangible asset value at 30 June 1985, but first the provision for contingent losses was increased from $8m to $12m.
While the negotiations and arrangements for the change of ownership of Tricontinental proceeded, the merchant bank continued to lend in accordance with the policy that had been confirmed in November 1984.

During 1985 the Tricontinental board reviewed the lists of persons delegated to approve credit submissions and the limits of their authorities, the lending criteria contained in the divisional operating guidelines, and several matters of credit reporting. Some changes were made in the reports to be given to the board, and an audit committee of the board was established, but no substantial alterations were made to the lending strategy.

Tricontinental's annual review for the year ended 30 June 1985 referred to its lending policy in the following terms:

"Tricontinental approaches its lending activities assiduously, specialising in providing a range of flexible credit facilities, tailored to meet each client's specific needs...

In today's rapidly changing financing markets Tricontinental realises the importance of not only satisfying clients' requirements but the vital need to be innovative, flexible and supportive and assist its clients' future growth...

Tricontinental's flexibility in the market is demonstrated by its creative ability to structure facilities with interest rates quoted on a fixed or flexible basis, with payments in arrears, advance or adjusted seasonally, and either on straight line or structured terms.

Lending activities reach all geographical areas, the portfolio being spread across all facets of industry throughout the nation. Tricontinental prides itself on assessing every transaction on its own merits. However, risk exposure to any client or industry is limited by our own financial management policies...

Tricontinental's demonstrated lending acumen and strength in past years, based on a commitment to service both the public and private sectors, has established a strong platform from which we can further add to our position as a leader in the ever changing corporate environment."
15.120 1985 also saw the establishment of a project finance division, to add:

"... a further new dimension to Tricontinental's existing wide range of services ... The division is a valuable adjunct to Tricontinental's lending division activities, providing clients with new funding techniques to meet their requirements and changing demands in the years ahead".

15.121 Following the acquisition, Tricontinental management felt the need for some guidance from the new owner as to the direction it wished Tricontinental to proceed. Towards the end of 1985, while Ryan was still managing director, Ryan, Johns and Ziebell met Moyle (as chief executive of SBV) to seek some idea of what SBV required. According to Johns, they came away without any clear picture of what SBV expected. Moyle did not propose any change of direction, simply "more of the same". In evidence both Ryan and Ziebell confirmed that they had formed a similar impression.

15.122 The Commission notes that Moyle stated in evidence that the traditional targets for merchant banks were businesses and high net worth individuals with high return investment opportunities, and to whom the cost of funds was less a consideration than the availability of funds. He believed that the ability to discuss projects with decision-making bankers, and the availability of fast decision-making processes, were vital. This was indeed the market segment targeted by Johns.

15.123 At the meeting on 26 March 1986 it was foreshadowed by Johns that a three year plan would be submitted to the board in May. Moyle asked whether the plan would include the development and diversification of products, and Johns confirmed that it would. The chairman (Smith) said that "this plan would be most worthwhile and beneficial for Tricontinental's shareholders so that they will have a greater understanding of the role of Tricontinental, and once adopted would provide a clear plan for the company and senior management".
At the meeting on 28 May 1986 the board confirmed new industry exposure limits for Tricontinental’s commitments as follows:

- Tourism 10%
- Investment 33%
- Mining 6%
- Property 33%

At the same meeting Johns presented the three year plan for 1987-9. He saw it as giving direction to Tricontinental, and it was a clear message to SBV. The introduction to the plan stated:

"The plan is also to provide the State Bank of Victoria with a clear indication of Tricontinental’s role over the next three years so both groups can develop to the mutual benefit of the total group, yet retain their independence and autonomy."

So far as the nature of lending was concerned, the plan did propose "more of the same" as suggested earlier by Moyle (see para 15.121 above). Moyle said in evidence that he believed Tricontinental’s expansion was not due to any change of policy by Johns, but due mainly to Tricontinental’s improved credit rating, allowing it to raise funds at lower cost. From there it was able to expand its assets more quickly.

It is significant that the plan stated that Tricontinental would in the future be less dependent upon profits from lending, as the size of the portfolio meant that it could be "more selective with its lending", and as less capital intensive activities, such as corporate advisory services and other fee-based activities, were expanded. It is even more significant that this aspect of the plan was not realized. That issue is examined in the next section of this chapter, which refers to the volume of lending.

Passages from the plan concerning the nature of lending activities were set out in para 22.15 of the first report, but they are so significant that they bear repetition here:
"LENDING DIVISION CURRENT STRUCTURE

The division prides itself in marketing the concept of assessing all proposals on their own merits - no rigid guidelines are in force and this allows managers to be innovative and commercial in their approach to financing. Although approval turnaround is quick, a necessary requirement in today's aggressive market, assessment is thorough, as reflected by the low level of non-accrual loans at 1% of total commitments. Naturally as the lending book expands potential losses are an accepted possibility, as a lender must take a risk in order to obtain a profit/margin. Little profit in no risk lending.

Approximately 90% of total lending commitments are secured therefore ensuring that potential full loss is remote. Tricontinental's marketing approach is one of - satisfy the client and let him advertise for you. Majority of increased business is obtained from existing clients and referrals/introductions from them. All industry exposures are continually re-assessed, however majority of lending is property/construction or equity orientated.

FUTURE DIRECTION

With every increasing competition from new entrants into the Australian financial markets, it is essential that Lending division continues to re-assess its product mix, geographical market presence, develop further products to cater for market need and to continue to provide personalised professional services to its established client base.

Lending policies and product diversification will continually be reviewed in order to always meet the market head on. Tricontinental will remain principally a secured lender within the private company and second tier public company sectors. Pricing of facilities will continue to reflect reward for risk, unnecessary volume will not be written at low returns. Tricontinental with its total lending commitments of $2 billion plus, now has a profitable base to be more selective with its lending ...

The plan went on to say that the existing structure of the lending division, approval mechanism, type of business and market strategy would continue. The majority of new business would be generated from "property/construction, equities, mining and tourism sectors". Tricontinental's lending activity was "opportunity driven", and it had "developed an appetite for proposals with predictable manageable risk, offering exceptionally high revenue/return opportunities". Tricontinental would "pursue these opportunities on a serious and deliberate basis". The
expected return was "25% per annum minimum return on all risk exposures plus funding risk reward where applicable". Lending division activity could involve staff increases of 10-12 over the next three years, but management was "well aware of the need of maintaining a tight control on staff numbers .... based on estimated 1986 figures Tricontinental will be rated number 3 [among AMBA members] in profits per employee".

Thus the plan highlighted a number of objectives that were deemed to be desirable in Tricontinental's future lending policy and practice. These included:

- Taking higher risk for higher profit.
- Accepting the possibility of losses with increased lending, in the belief that full loss on secured lending was remote.
- Ensuring that lending policies and product diversification always met market needs.
- Applying flexible guidelines, with an innovative and commercial approach to financing.
- Having a quick turnaround of approvals, but with thorough assessments.

These objectives were summed up by a proposition in the plan that could well have been Tricontinental's slogan: "satisfy the client and let him advertise for you".

The minutes of 28 May 1986 record that the directors considered that the plan was "good, aggressive and objective". Morton commented that the aim of autonomy for Tricontinental was a good idea. Moyle, however, made the following points:

- SBV is subject to Reserve Bank prudential limits, which may impact upon Tricontinental.
- The plan required good liaison and co-operation with SBV.
- Achievement of the plan required high calibre staff, and the taking of risk in regard to the lending book and trading operations.
Improved reporting to the board was needed due to the higher risk and complexity of a number of the products outlined in the plan.

The plan did not address securitisation.

In evidence, Johns commented upon the above points made by Moyle. He said that the impact of Reserve Bank prudential limits fell upon Tricontinental's lending, and this called for reassessment not only of Tricontinental's resources but also its profitability. The requirement for good liaison and co-operation with SBV referred principally to treasury activities. Physical premises were shared by treasury operators, but they maintained separate desks, and merger was resisted by Johns and other senior managers at Tricontinental. The need for improved reporting due to the higher risk and complexity of products did not lead to specific changes in reporting to the board, although some changes did in fact occur, such as a quarterly report on listed equities held as security for loans, and changes relating to the reporting of liquidity, gearing, non-accrual loans and default loans.

It is particularly significant that Moyle identified the need for high calibre staff (which implied a need for high calibre lending assessments) and the need for improved reporting (which implied a need for close monitoring by the board). Moyle referred to Reserve Bank prudential limits in terms of the impact upon Tricontinental, but plainly a related aspect was the potential of Tricontinental's lending to have an impact upon SBV.

The board's acceptance of the lending strategy set out in the three year plan was reflected in the review that accompanied Tricontinental's annual accounts to 30 June 1986. Under the heading of "Growth Through Innovation", Tricontinental's lending philosophy was stated in the following terms:

"Tricontinental has a philosophy of supporting entrepreneurial starters and growing with them. When people have an idea, cashflow and potential, and the idea makes sense, Tricontinental
will support them. Tricontinental is different from most other merchant banks in that it stays close to its clients and "gets its hands dirty" by being supportive. This philosophy has obviously paid off, as Tricontinental's credit rating has continued to increase. Tricontinental has been moving away from the pack for some time now, shifting an amount of attention toward the business of medium-size public companies and larger private companies, with the view to cultivating the entrepreneurial spirit that will provide the greatest growth to Australia."

15.134 This purple passage was balanced to some extent by a more cautious statement later in the review. It echoed several of the points made by Moyle at the board meeting in May:

"Credit policy and prudential management are directed to the maintenance of high-quality loan assets and a balanced portfolio to avoid undue exposure to any industry segment by region or company/individual group. Credit appraisal and risk management are by a system of delegated authority through a committee system. All exposures are regularly monitored and intensive management of loans is undertaken where financial deterioration is evident."

15.135 A great deal of the Commission's inquiry has been devoted to investigating whether or not the board, chief executive officer and senior managers of Tricontinental lived up to those objectives. The simple fact is that they did not.

15.136 At the meeting on 25 June 1986 the board considered the internal operating guidelines contained in a booklet dated June 1986. A number of discrepancies were pointed out by board members.

15.137 At the meeting on 25 March 1987 the board considered Tricontinental's lending guidelines and the acceptance of shares as security. The minutes record the following:

"The Managing Director advised (the) Board of Tricontinental's current practices and policies in this regard and gave certain assurances as to the cover required and the monitoring of the cover."
The Directors agreed that they were comfortable with the security ratios outlined in the paper and noted the Managing Director's advice that the sum of [all clients' security exposures] to any one company cannot exceed 5% of that company's issued capital. The Board further noted that exceptions would exist to the 5% limit e.g. take-overs. The Board asked that a schedule of all lending against shares be provided on a quarterly basis.*

The minutes quoted above illustrate the elastic nature of Tricontinental's lending policies. The 5% limit of exposure to a company's issued capital is said to be subject to "exceptions", e.g., takeovers. This policy does not provide guidance as to what the extent of exceptions to the 5% limit should be. Indeed, in the transactions investigated by the Commission, exceptions to this 5% limit occur with considerable frequency: shares representing more than 5% of a company's issued capital formed security for the loans to the Qintex group of companies, Smith & Lane, Rocado Investment & Finance, Dallhold, companies in the Goldberg group, Atoll Corporation, Duke Securities, Quatro Limited and Pro-image. In fact the Commission could detect no consideration ever being given to this supposed guideline.

At the meeting on 27 May 1987, the board considered the profit and capital budget for the year ending 30 June 1988, and an addendum to the May 1986 three year plan.

Mr Moyle commented that the budget was ambitious and asked that the following points be noted in the minutes:

- *Planned growth and profitability should not however be achieved by sacrificing prudential standards in regard to credit assessment, trading practices on open positions outside approved limits and delegation, or other high risk exposures.*

- A degree of competition between the State Bank of Victoria and Tricontinental is inevitable and healthy. This however should not be allowed to result in wasteful Group duplication of resources and activities, conflict for markets or for the business of crucial clients or the creation of opportunities for other market participants to arbitrage against the two group members.
• Expansion of offshore activities is considered entirely appropriate but there is a need for close and continuing two way consultation between State Bank of Victoria and Tricontinental, particularly in regard to capital market issues, special and ongoing relationships with particular finance institutions and sharing of market intelligence (to the extent possible).

• The Managing Director acknowledged Mr. Moyle’s comments confirming that prudential standards on credit assessment would be adhered to and the State Bank of Victoria would be consulted in relation to offshore capital market issues and market intelligence. The Managing Director also sought similar consultation from the State Bank of Victoria and that information flow was not all one way."

At the board meeting of 16 December 1987, Rawlins asked that a paper be tabled at the next board meeting setting out recommendations for the overall limit of mining leases to be accepted as security for lending facilities, as he considered that mining leases could be of little value. At the meeting held on 27 January 1988 the board agreed that Tricontinental’s exposure to mining leases was not to exceed the greater of $300m or 7% of total lending commitments.

In the wake of the stock market crash of October 1987, the Tricontinental board reviewed its lending policy and practice. See first report, paras 13.54-62. This led to some tightening of guidelines, as discussed in the section on lending criteria later in this chapter. In early 1988 Mr Rawlins had a real concern about Tricontinental’s exposure to equities, and management’s attitude to providing adequate information to the board, to the point where his concern led to his resignation from the board in April 1988. In contrast, Mr Smith said in evidence that although he thought, immediately after the crash, that there may have been a change in Tricontinental’s lending pattern, as 1988 progressed it was evident to him that Tricontinental had not suffered. He believed that the same degree of confidence as before probably continued. He was not aware of any substantial change of policy at that time.
15.143 At the meeting on 24 February 1988 the board considered Tricontinental's divisional lending guidelines. The minutes record the following:

"Divisional Guidelines:

The Managing Director led the Board in a discussion on the Divisional Guidelines which were presented with the Board Papers. Mr Moyle advised that this was an appropriate time for conservative views in light of the current economic climate. However due to other matters presently under development it was agreed that the Guidelines would not be amended however in regard to Lending limits the existing arrangement between Mr Johns and Mr Moyle will continue."

The significance of this minute is discussed in detail later in this chapter, commencing at paragraph 15.268.

15.144 The submission, dated 18 January 1989, to the Reserve Bank about the proposed merger between Tricontinental and Australian Bank, signed by Johns on behalf of Tricontinental, indicated continuing confidence in the policies and competence of Tricontinental. The following claims were made:

- There was a significant demand for Tricontinental's services and style of conducting business.
- Current management had demonstrated its ability in assessing and minimizing credit risk.
- The characteristics of Tricontinental's "traditional client base" included -
  - business people who were innovative and had well defined objectives
  - businesses which had the ability to grow; produced results quickly; required quick decisions, confidentiality and a high degree of banker flexibility
  - "new wave" industries such as tourism, leisure, entertainment and technology.
The submission accepted that as a consequence of the type of facilities provided and the existing client base, Tricontinental had "a large exposure to a relatively small number of clients". And it accepted that the client base included "customers who are occasionally perceived by the traditional financial services sector as high risk". The implications of that exposure were met by statements that Tricontinental had developed "significant expertise in assessing and minimising the credit risk".

The submission also sets out examples of the way in which Tricontinental sought to meet the needs of clients. Financing practices that were the "predominant key" to Tricontinental's growth included:

- The ability to blend debt and equity funds efficiently.
- Taking a commercial view of security; "bricks and mortar are not seen to be the only satisfactory forms of security ... cash flow lending, including potential as well as actual earning streams, and trading asset security are something Tricontinental understands".
- A realistic and flexible approach to purposes for which loans are made.
- Not avoiding specific types of organizations or people - Tricontinental had developed successful business relationships with clients not acceptable to traditional banks - particularly new and small to medium sized Australian companies.
- An open minded approach to funding requests.
- A quick response to customer requests.

Once again, Tricontinental was parading as virtues the very factors which were to lead to its downfall.

An appendix to the submission set out six customer case studies "which encapsulate Tricontinental's total banking philosophy". They were said to illustrate Tricontinental's greater willingness than most other financial institutions to provide resources and support for innovative ideas and new
ventures. It is notable that of the six case studies chosen (and no doubt chosen very carefully) three of them were:

- Qintex Limited
- Pro-image Studios Limited
- Interwest Limited

15.148 The submission claimed that the Qintex group's strong growth and investment vindicated Tricontinental's willingness to provide resources to business people assessed as having sound management skills and vision.

15.149 The submission stated that the growth of Pro-image in the three years since Tricontinental helped launch the company had been outstanding, and that Tricontinental was proud to have lent its support to this dynamic Australian company.

15.150 The submission noted that Tricontinental had provided the finance for John Avram to take the initial steps from his fruit-growing background into the hotel industry, to the point where the Interwest group, backed by Tricontinental, had developed into one of the major participants in the Australian tourism and leisure industry. Since advising on and providing the finance for the 1984 restructuring of Interwest, Tricontinental's involvement had encompassed all aspects of the group's development. The inference, of course, was that Tricontinental knew how to pick winners.

15.151 Each of Qintex, Pro-image and Interwest has been the source of losses to Tricontinental - massively so in the cases of Qintex and Interwest. Qintex and Pro-image were each the subject of public examination by the Commission, and feature in the transactions discussed in detail in this report. Interwest would have been the subject of similar public examination and report but for the fact that the Commission was preempted by major civil litigation in the Supreme Court of Victoria between Avram, Tricontinental and others. However, the Interwest group was
included amongst the transactions reviewed privately by the Commission (see chapter 3).

15.152 The Tricontinental board adopted a deliberate strategy of providing large facilities to particular clients. This involved a high concentration of credit risk. The major transactions examined by the Commission overwhelmingly involved loans to groups of companies which were repeat borrowers from Tricontinental. Several transactions were initiated by persons who had some other previous connection or dealing with Tricontinental. Thus loans to the DAC group were initiated by a former employee of Tricontinental (Mr Peter Hunt) who was a principal of Rocado, and in the case of Atoll Corporation, the principal (Mr Robert Sng) had been involved in resolving problems concerning loans by Tricontinental to a borrower in which Mr Sng had some ill-defined interest.

15.153 Tricontinental's clients were characterised by an absence of established, maintainable cash flows from which Tricontinental's loans could be serviced and repaid. This characteristic was inherent in the lending market segment identified by Tricontinental. Tricontinental's clients were, almost without exception, engaged in new business ventures or developments, the acquisition and restructuring of existing businesses, or investment in assets - particularly shares and commercial property. Such cash flow as these clients had depended upon:

- asset sales;
- additional borrowings, frequently secured by an unrealised increase in the value of assets held; or
- the raising of new equity capital by the issue of shares to the public.

Each of the sources of cash flow depended critically upon increasing asset values. The ability to raise additional capital from the public was very severely affected by the fall in share values after the stock market crash in October 1987.
Transactions which demonstrate the fundamental nature of Tricontinental's lending activities include the following:

(i) Atoll Corporation:

Atoll Corporation was a private investment company with no assets or sources of cash flow other than the shares acquired with the loan provided by Tricontinental. A lending officer, Mr Stephen Brown, estimated that of the credit submissions he prepared, approximately one quarter to one third of the transactions involved lending to a "shelf company".

(ii) The Quatro group:

The Quatro companies (Quatro, Pro-image and Disctronics) were a new, 'start-up' public group without established sources of cash flow. Quatro was a listed public company whose activities changed from the manufacture of funeral requisites to investment and the provision of management services. Pro-image was in the process of expanding from a small, Adelaide-based video marketing company. Disctronics was involved in the 'green field' development of a compact disc manufacturing operation in Australia, and the acquisition of similar established manufacturing facilities overseas.

(iii) The DAC group:

Smith & Lane Holdings and Rocado Investment & Finance were public companies acquired for the purpose of changing their business to that of investment and management services. Their principal activities became share investments, and investments in foreign casino operations (through Churchill Leisure and Amaldela). (The acquisition of listed public companies enabled earlier access to public equity markets than the procedure of listing a new company. Such 'back-door' listings were also used by Quatro and Disctronics.)
(iv) The Essington group:
The success of lending to the Essington group for property development depended upon obtaining crucial development approvals, and the ability of Essington to complete and sell the projects, or arrange refinancing of the projects. In the absence of a committed takeout, the projects would inevitably result in losses for Tricontinental if there was a significant downturn in the commercial property market.

(v) Dallhold (part of Bond group):
Success of the $100m facility to Dallhold depended on the successful public float - in effect, a partial sale - of Bond Broadcasting Corporation.

(vi) Skase group (which included the Qintex group, and Kahmea):
The Skase group of companies was described in evidence as principally an asset trader with continuing cash flow problems which became acute with the downturn in asset values in 1988 and 1989.

At the meeting on 26 April 1989, the board considered the tight liquidity situation, and Tricontinental’s lending policies. It is appropriate to set out the relevant minutes in full:

"Mr Moyle advised that as Tricontinental was presently operating within a tight liquidity situation, the company needed to redefine and tighten its lending policies, and reduce its current levels of lending.

Mr Ryan advised that the company should assess its credit policy very quickly and that its policy was not that of a conservative banker. Mr Ryan suggested that Tricontinental's current lending policy was ‘... like a desperado trying to get out of [debt on] the last race at Flemington’.

Mr Moyle suggested that the policy cover:

a. only lend to those who have the ability to repay."
b. more stringent rules on lending on scrip, by increasing the cover and ensuring shares are well traded.

c. look more closely at property development and not to finance 100% nor capitalise interest, to finance 75% of valuation unless separately insured.

Mr Johns advised that the company rarely financed on 100% valuation, usually 80% of production costs which represented less than 75% valuation. [The fact that the guidelines stipulated a limit of 70% of valuation seems to have passed without comment.]

Mr Moyle advised that he was satisfied with the current lending delegation. Based on the company being 100% owned by the State Bank of Victoria, Mr Ryan concurred with Mr Moyle's opinion regarding the current lending delegation. [Mr Ryan denied the accuracy of this last sentence.]

Mr Johns advised the meeting that he would not be utilising his discretion and that more submissions would be circulated to directors.

Mr Smith informed the meeting that he will be advising the Board of the State Bank of Victoria that due to recent liquidity difficulties and bad debt history the company was reassessing its lending policies to alter the above situation.

The Board agreed that management table a paper on revised lending policy for discussion at the next meeting. * 

15.156 The comments by Ryan and Moyle were particularly significant for what they implied about past lending policies. For Ryan's explanation of his attitude at that time, see para 16.33 of the first report. In part, he said:

"My view was that the current policy was increasingly being demonstrated to have failed, by the growth in non-performing loans. I expressed the view that Tricontinental should immediately adopt more conservative policies."

Ryan's remark that Tricontinental's current lending policy was "... like a desperado trying to get out of [debt on] the last race at Flemington" was probably a reasonable description of transactions such as Tricontinental's financing of the sale of Direct Acceptance shares to Duke Securities (to recover the Rocado loan), financing the sale of non-performing loans and
assets to Markland House, and financing the sale of assets of Intellect Electronics to Essington Developments. All of these facilities were approved by directors.

15.157 The Commission notes that, although there is no record of it in the minutes, Ryan preceded his comment about Tricontinental lending "like a desperado" with the words "no lessons learned from mistakes", according to a memorandum dated 5 May 1989 from Johns to Mountford.

15.158 Moyle's suggested changes were profound, identifying as they did the need to lend only to those "who have the ability to repay", the need for more stringent rules on margin lending to ensure that the shares were "well traded", and the tightening of lending for property development. All these suggestions were soundly based and long overdue.

15.159 As recently as 3 December 1991, in evidence to the Commission, Johns remained unrepentant about the general thrust of the lending strategy put forward in 1986. He commented as follows upon para 22.15 of the first report (which was the extract from the three year plan repeated in para 15.128 of this report):

"A lender must take a risk in order to profit. Tricontinental's marketing approach was to satisfy the client and let him advertise for us. That achieved a 'snowball effect'. The majority of new business came from existing clients and referrals/introductions from those same clients."

15.160 In evidence Johns acknowledged that Tricontinental had large exposures to a small group of regular clients. He didn't think he ever hid that fact. From his observations, it was well known to each member of the Tricontinental board.

15.161 The Commission makes the following findings about the nature of Tricontinental's lending:
(i) The Tricontinental board deliberately adopted a strategy of providing large loans and other credit facilities to a relatively small number of clients. The result was a high concentration of credit risk.

(ii) The nature of the clients and their entrepreneurial business activities meant that not only was the credit risk concentrated, but also the risk was often high. The board deliberately accepted high risk in the pursuit of high reward. This was the perception of merchant banking adopted by the board, and it was reflected in its lending strategy.

(iii) The theory was that the high risk would be confined within acceptable limits by skilled managers and staff, and by appropriate supervision by the board.

(iv) Given the fundamental danger of embarking upon such a high risk strategy, it is doubtful whether even excellent management could have enabled the strategy to succeed. In the event, the performance by both management and board was less than adequate for the strategy which the board had endorsed.

(v) As already discussed in chapter 11 of this report, Tricontinental’s lending strategy relied heavily upon perceptions of security, spiralling asset values, takeout arrangements, and ‘name lending’, rather than upon a client’s cash flow and basic ability to repay. Mr Moyle’s plea in April 1989 to lend only to those "who have the ability to repay" was years too late.

(vi) In the opinion of the Commission, the evidence shows that the board’s lending strategy was so fundamentally dangerous that its prospect of lasting success was never strong.

(vii) The deliberate strategy of exposing Tricontinental to concentrated high risk, in the pursuit of high reward, was one of the principal factors that contributed to the merchant bank’s collapse.
15.162 The growth and size of the loan portfolio

In the four years to 30 June 1989, Tricontinental’s portfolio of drawndown loans more than tripled in size, from $967.6m to $3,442.3m. The growth was most spectacular immediately after the acquisition of Tricontinental by SBV - in the year ended 30 June 1986, drawn-down loans increased by 95%. The increase in 1987 was 45%, in 1988 it was 17%, and in 1989 7%. The four-year growth in total loan commitments was almost identical.

15.163 Tricontinental’s growth, facilitated by the increased access to funds brought about by SBV ownership, was not only rapid, but warmly applauded. By June 1986, Tricontinental boasted of having become Australia’s largest merchant bank. Mr Johns was named the Bulletin/Compaq "Young Executive of the Year" for 1986, and Tricontinental was named by "Australian Business" magazine as Australia’s "most improved company" in its inaugural "top 500" business awards. Tricontinental’s practice of taking a significant proportion of its lending profits in the form of up-front fees - 42% according to Mr Mountford - meant that the growth in lending was accompanied by a spectacular increase in profits. Profit before tax but before extraordinaries increased by 175% in 1986 (from a depressed 1985 result), and by a further 103% in 1987, before declining by 11% in 1988 (the year of the stock market crash). A year later, Tricontinental’s losses were on the way to destroying its parent, SBV.

15.164 With hindsight, the rapid growth of the loan portfolio was a sure sign of impending problems. Again with hindsight, the reason is simple. Lending money is, in the end, subject to one basic and immutable consideration - will the loan be serviced and repaid? In a highly competitive corporate lending environment, rapid growth can be achieved in only one way - by lowering credit standards. Those financial institutions which expanded their loan portfolios most rapidly in the 1980s - the newly established foreign-owned banks, some state banks and some merchant banks - have suffered most severely from loan losses.
15.165 The rapid growth of Tricontinental's loan portfolio raises the questions: was the growth planned? What constraints were applied to the growth of the portfolio?

15.166 The answer to the first question is that the rate of growth of the loan portfolio was not planned. In each of the three years after June 1985, both the increase in total loan commitments, and the total commitments at year end, exceeded budget. Details of the growth and size of the portfolio which were provided at paras 10.12-17, 11.3-5 and 13.3-7 of the first report, and paras 10.100-108 of this report, can be summarised in the following table (refer also to para 10.101):

<table>
<thead>
<tr>
<th>Year Ended 30 June</th>
<th>Increase in Loan Commitments</th>
<th>Total Loan Commitments At Year End</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Budget ($m)</td>
<td>Actual ($m)</td>
</tr>
<tr>
<td>1986</td>
<td>330</td>
<td>1,120</td>
</tr>
<tr>
<td>1987</td>
<td>500</td>
<td>1,020</td>
</tr>
<tr>
<td>1988</td>
<td>400</td>
<td>630</td>
</tr>
</tbody>
</table>

15.167 In considering the budget for 1988 at the May 1987 board meeting, Mr Moyle noted that the plan was "ambitious", and warned that growth should not be achieved "by sacrificing prudential standards in regard to credit assessment". Apart from this note of caution, Tricontinental's directors seem not to have been concerned at the credit risk implications of rapidly expanding the portfolio, nor with management's repeated failure to restrain the growth of lending to within budgeted figures. Indeed, the unbudgeted growth was apparently not a matter of particular notice - Mr Ryan told the Commission that, so far as he could recall, the expansion of the portfolio was in accordance with the annual budgets.
The only restraint upon the growth of the loan portfolio was unrelated to credit risk management considerations. The restraint came, instead, from Tricontinental's gearing ratio - the ratio of its own debt to its capital base. This restraint had two sources - from the maximum gearing ratio established by the board of directors in May 1985, and, with increasing urgency after 1987, from SBV, whose own capital adequacy (which was measured on a group basis) was embarrassed by Tricontinental's high gearing. The Commission's first report, at paras. 14.1-19 and 15.2-5, described the pressure applied by the Reserve Bank upon SBV to ensure its capital adequacy.

Tricontinental's board of directors established a maximum gearing ratio and maximum potential gearing ratio at its meeting on 17 May 1985. At that meeting, Mr Ziebell presented a paper on the gearing of Tricontinental which informed the board that the Australian Merchant Bankers' Association ("AMBA") rules required members not to exceed a balance sheet gearing of 25 to 1. Ziebell also said that he had been informed by Australian Ratings that the acceptable potential gearing level was 30 times for a merchant bank primarily concentrating on its lending portfolio, and 35 times for a merchant bank with a lending and trading portfolio. The board then considered a report by the managing director (Ryan) on gearing as set out in board papers, and resolved that the balance sheet maximum gearing level be 25 to 1 and the maximum potential leverage gearing ratio be 35 to 1. The board also resolved that a gearing paper be presented to each board meeting.

At the meeting on 20 September 1985 the board considered a paper tabled by the managing director on the group trading results, balance sheet and gearing schedules. Moyle noted that the group's potential leverage gearing ratio was in excess of the board limit, and asked senior management to prepare a paper for the next meeting, showing how the group would continue its present mode of operations while still remaining within board approved gearing ratios.
In evidence Rawlins said that in 1985 and 1986 Tricontinental was, in effect, SBV's corporate lending arm, while SBV was developing its own expertise. During the period when he was a director (April 1985 to April 1988) Tricontinental experienced substantial growth in lending. Treasury activities became less important following the floating of the exchange rate and the reduced attractiveness of trading in money market securities. Moyle acknowledged in his evidence that the growth of the loan portfolio in the years 1985 to 1987 had been rapid.

At the board of directors' meeting on 26 March 1986, Moyle said that the proposed three year plan should include details regarding gearing, and that any increase in assets should be geared to Tricontinental's ability to expand its own capital base through an increase in retained profits. The need to limit the rate of growth of the loan portfolio was a continuing source of discussion and planning by Tricontinental management (first report para 11.41). However, the growth of Tricontinental's total loan commitments continued to exceed both the budgeted growth, and the level that could be sustained within the gearing ratio guideline on the basis of Tricontinental's internally generated capital. In June 1986, SBV contributed $15m of additional capital to Tricontinental in the form of a subordinated loan, and agreed to forego the receipt of a dividend. In 1987 and 1988, SBV returned its dividends from Tricontinental in the form of a capital contribution of $10m, and a subordinated loan of $8m.

Amendments to the three year plan in May 1987 referred to a "planned reduction in rate of commitment growth (compared to recent years) with a view to reducing gearing and leverage ratios", and included a proposal to engage a manager to syndicate both some existing loans, and new loan proposals. The plan proposed a $250m divestment of existing loan assets in 1988, and divestments over 3 years totalling $1 billion.

The proposed divestments of loans by syndication was not achieved. Mr Mark Waldron was appointed manager special projects in about June 1988, but he
did not have any particular expertise in loan syndications. Waldron said in evidence that, "During my time as manager special projects, I undertook the preparation of [a] transaction to sell down one debt and one only".

At its meeting on 16 December 1987, the board noted that Tricontinental’s balance sheet and potential leverage gearing ratios had been exceeded. Moyle informed the board that SBV had been told by the Reserve Bank that it must reduce its gearing. Tricontinental was asked to consider how it would contribute to the solution. At the meeting on 24 February 1988 Moyle again raised his concern, and informed the board that SBV was under pressure. He was told that a plan on capital adequacy, and its impact upon Tricontinental’s corporate plans, would be tabled at the next meeting.

At the meeting on 23 March 1988, Johns led the board in a discussion on Tricontinental’s capital adequacy, based on a discussion paper issued by the Reserve Bank. Moyle asked that a paper be tabled at the next meeting on how Tricontinental’s current corporate plan would be amended in the light of the capital adequacy requirements.

At the meeting on 4 May 1988, Moyle informed the board that SBV’s allocation of capital was based on growth prospects and profit, and that at present Tricontinental utilised approximately 23 to 25% of the group’s risk assets. Tricontinental’s projected 1988 and 1989 profits of less than 20% did not warrant a further capital allocation, and the company should be self-sufficient. Board papers stated that future asset lending would rely upon the amount that could be securitised (first report, para 14.18).

At the meeting on 22 June 1988, capital adequacy queries emerged again in the context of the profit and capital budget for the coming year. (Details of the lending division budget are set out in paras 13.75-78 of the first report.) Moyle said that Tricontinental should work on the basis that it was to be self sufficient in generating capital, and that SBV had a Reserve Bank requirement
to adhere to a 6% overall balance sheet capital adequacy ratio by 30 September 1988. Moyle also asked that further consideration be given to the following matters:

• growth targets - on and off balance sheet items - in different products/divisions;
• allocation of resources between divisions;
• promotion or winding back of activities;
• concentration of risk.

Moyle requested that a submission be presented to the board based on the budget and which dealt with these issues.

15.179 At the meeting on 22 August 1988 the budget item was deferred to the next meeting. At the meeting on 28 September 1988 the board discussed a budget paper, and agreed that the matter required further consideration. Minutes of later meetings do not record the nature of any response to the specific and important matters raised by Moyle at the June meeting.

15.180 The growth of the loan portfolio meant that, even with capital contributions from SBV, Tricontinental’s gearing ratio - which was set at the outer limit of that acceptable for AMBA members - was under constant strain. Tricontinental’s submission to the Reserve Bank, dated 18 January 1989, summarised its capital gearing ratio as follows:

<table>
<thead>
<tr>
<th>Year to 30 June</th>
<th>Total borrowings $m</th>
<th>Shareholders funds $m</th>
<th>Gearing (times)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>812.0</td>
<td>48.1</td>
<td>16.9</td>
</tr>
<tr>
<td>1985</td>
<td>1,046.1</td>
<td>49.5</td>
<td>21.1</td>
</tr>
<tr>
<td>1986</td>
<td>1,971.5</td>
<td>81.2</td>
<td>24.3</td>
</tr>
<tr>
<td>1987</td>
<td>2,810.2</td>
<td>107.1</td>
<td>26.2</td>
</tr>
<tr>
<td>1988</td>
<td>3,189.2</td>
<td>131.4</td>
<td>24.3</td>
</tr>
<tr>
<td>1989*</td>
<td>3,289.4</td>
<td>131.5</td>
<td>25.0</td>
</tr>
</tbody>
</table>

* (at 31 December 1988)
In the submission, the following explanation was given:

"The capital gearing ratio has remained high, particularly in the past three years, because of the strong demand for Tricontinental's services. The growth in facilities provided to clients has been controlled so as to ensure that total borrowings do not become excessive."

Australian Rating reports noted the high gearing ratio, saying that by "industry standards, gearing is ... in the highest quartile of the industry range". Australian Ratings attributed the high gearing partly to SBV's "own capital position and limited access to new capital from the Government of Victoria".

As already noted in paras 13.123-4 of this report, some steps were taken to develop corporate advisory services and other fee-based activities, but little was achieved by way of balancing Tricontinental's lending activities. Johns himself put most of his effort into investment banking and acting as account manager for almost all the major loans of Tricontinental. The acquisition of 'assets' by Tricontinental, in the form of loans to clients, consistently exceeded the figures provided for in budgets.

The failure of the strategy to shift the growth in Tricontinental's business away from asset-based lending to less capital intensive activities is reflected in the profit figures. The three year plan had envisaged that the contribution to the operating profit from lending activities would fall from 45% in 1986 to 33% in 1989. The actual results were 50% in 1988 (compared to budget 28%), and 91% in the eleven months to 31 May 1989 (compared to budget 33%). (The percentage reliance on lending in 1989 was aggravated by losses suffered in investment banking.)

The Commission makes the following findings about the growth and size of Tricontinental's loan portfolio:
(i) The growth in the size of Tricontinental's loan portfolio following the assumption of control of Tricontinental by SBV in April 1985 was very rapid, particularly in the years ended 30 June 1986 and 1987.
Both the rate of growth, and the total size of the loan portfolio from year to year, significantly exceeded the budgeted figures.

(ii) The only constraint placed on the size of the loan portfolio was Tricontinental's maximum gearing ratio guideline established by the board of directors in May 1985.

(ii) The maximum gearing ratio of 25 to 1 was high by industry standards. It was at the extreme limit of the ratio acceptable for membership of the Australian Merchant Bankers Association.

(iv) Even this high maximum gearing ratio guideline was placed under constant pressure by the growth in the loan portfolio. Tricontinental's actual gearing ratio was constantly near its internally set maximum - see the table at para. 15.180 above. Maintenance of the ratio within the guideline required additional capital contributions to Tricontinental by SBV.

(v) Although plans were made to slow the rate of growth of the loan portfolio, to run-off or sell down some existing loans, and to promote growth in less capital-intensive businesses, none of these plans was successfully implemented. Effective steps were not taken by either the board or management to restrain the growth of the loan portfolio to within budgeted targets.

(d) The size of loans to client groups

The rapid growth of Tricontinental's loan portfolio was associated with an increase in the size of its loans to particular borrowers or groups of borrowers, particularly after 1986. Tricontinental told the Reserve Bank, in its submission dated 18 January 1989, that there had recently "been a tendency to centre growth upon the needs of existing clients rather than new ones because of resource limitations" - a reference to Tricontinental's limited capital base.

In late May 1986, McAnany submitted to Moyle a draft memorandum proposing credit risk and loan exposure limits for each member of the SBV
group, including Tricontinental. He proposed that Tricontinental’s exposures should be confined to 20% of its own capital base for any one client group.

As a number of Tricontinental’s existing loans already exceeded the proposed limit, it was envisaged that they would be sold down. It followed that Tricontinental’s future lending would be more constrained than its past lending. This could have been ameliorated by Tricontinental, with the consent of SBV, being allowed to "borrow" capital utilisation capacity from SBV (if it were unused by SBV itself for the particular client group), so that Tricontinental’s exposure might be increased to 50% of Tricontinental’s capital as defined for prudential calculations.

Moyle rejected McAnany’s proposal. According to McAnany, Moyle argued that Tricontinental was operating in a different market niche from SBV, and was developing areas of corporate banking which would not otherwise have been "accessed" by SBV. A modified form of McAnany’s paper did go to the SBV board later in the year, but it was confined to proposals for prudential limits and controls for SBV alone.

In July 1986 Mr Bob Escudier, assistant general manager corporate banking of SBV (who had worked with McAnany on the earlier draft rejected by Moyle), proposed to Johns that Tricontinental’s lending be limited by reference to its capital base. The limits ranged from a maximum of $5m for an unsecured loan to an individual client, to a maximum of $10m for a secured loan to a client group of companies (approximately equivalent to 20% of Tricontinental’s shareholder funds). If SBV was not using its maximum exposure of 20% of SBV’s capital base to a client, Escudier proposed that Tricontinental would be able to "borrow" capital utilisation for that client to a maximum of $25m.

The proposed limit of $10m was only about one-tenth of 20% of SBV’s capital base. The proposal by Escudier had not been authorised by Moyle, as chief
executive officer of SBV, and when he found out about it, he regarded the proposal as completely inappropriate. Moyle accepted the proposition that, in order for Tricontinental to make ground in its market segment, the ability to commit $100m was often necessary. According to Johns, both he and Moyle considered that Escudier's proposal would have made Tricontinental unworkable as a merchant bank.

The full significance of Escudier's proposal, if it had been adopted, was shown by a summary of Tricontinental's client exposures put to the July board meeting by Johns. At the time Tricontinental's capital base was $66.2m (excluding subordinated debt). Commitments to 20 different clients each exceeded 30% of Tricontinental's capital base. In 14 of the 20 cases, exposures exceeded 50% of the capital base. In 4 cases, the exposures exceeded the entire capital base. Those 4 largest exposures together totalled $489.5m, more than seven times Tricontinental's capital base, and more than the capital of the consolidated SBV group. The largest exposure to a single client was $190m, almost three times Tricontinental's capital base.

Johns put Escudier's proposal to the Tricontinental board at its meeting on 23 July 1986, and argued strongly against it. The minutes record that:

"Mr Moyle agreed with the managing director that the imposition of exposure limits as set out in the paper would result in profit projections not being met ... Mr Moyle advised that the State Bank of Victoria were still addressing this matter and it was agreed that this paper be deferred to the August 1986 board meeting and if necessary be updated should additional material or information be available."

Presumably the "matter" still being "addressed" by SBV was the possible issue of formally approved guideline limits on an SBV group basis.

Tricontinental's minutes for the meeting in August 1986 and for later meetings do not record that the issue of exposure limits was ever brought back to the board.
Smith and Morton had no recollection of an understanding with SBV as to exposure limits, or the sharing of lending capacity. Ryan and Rawlins recalled only information-sharing arrangements. Carr was not a member of the board at that time, but was closely involved with submission approvals as an alternate to Moyle. He said that he was aware that the maximum Tricontinental could lend to any borrower "was 20% of the State Bank's capital base", but was not sure of the source of his knowledge. On the other hand, Moyle, Johns and Ziebell were more positive, as set out below.

Moyle said that he had put forward a counter-proposal to that of Escudier. It was that:

"Tricontinental should at that time adopt the same limit as it had been operating under de facto for some time, namely, about 20% of the State Bank's capital base which came out to about $100m. It had been expressed that I increased the lending limit proposed by the bank tenfold. In fact, the true position is that I over-rode Mr Escudier's own proposal for a $10m limit and restored the position to what it had been, virtually de facto, for a number of years, and increased it a bit to take account of inflation and the growing, as I perceived it, strength of Tricontinental."

Moyle's recollection was that amounts were agreed upon and endorsed by the other directors. They were $50m for an unsecured individual client, $75m for a secured individual client, and $100m for a secured client group. He denied that the aggregated loan exposure policy was a "Moyle/Johns arrangement". He said that he had merely indicated to Johns that he would support a limit up to $100m, and that was "known to the board of Tricontinental". He said that it was well understood by Johns and the other directors that the exposures of Tricontinental and SBV to a particular borrower would be aggregated, up to the limit calculated by reference to SBV's capital base. Moyle also said in evidence that the $100m limit was not intended to be long term, but was simply the amount which at the time represented 20% of the SBV group's capital base.
The extraordinary absence of any minute of this important decision leaves in doubt whether the decision was to adopt 20% of the SBV group’s capital base as a continuing limit, or whether the figure of $100m was adopted - on the understanding that it would be reviewed from time to time in accordance with increases in the group’s capital base. The question could be significant were it not for the absence of any suggestion that the board ever applied any limit to its group exposures.

Ziebell was the minute-taker at Tricontinental board meetings. He had no independent recollection of the discussion at the July 1986 board of directors meeting. However, he was aware that Tricontinental was able to advance loans to borrowers by having regard to SBV's capital base. Indeed, the Three Year Plan had been drawn up on that premise. He said that he had a "fairly clear recollection" of Johns showing him a letter from Moyle "saying that in terms of Tricontinental’s exposure we could use State Bank group shareholders’ funds for our shareholder base." Ziebell's recollection was based on the fact that it was "a fairly important matter at the time" since it was "very important for our Australian rating in terms of using shareholders’ funds".

Significantly, notes taken by Ziebell at the July board meeting made it clear that the concept of an aggregated SBV/Tricontinental exposure limit of $100m for secured lending to any one client group was discussed quite extensively, together with the mechanics of sharing the exposure with SBV in the case of mutual clients.

Johns said he had no doubt that the $100m limit was known to the Tricontinental board. He documented the exposure limits stated by Moyle in a file note dated 23 July 1986, the day of the board meeting. Mountford said in evidence that the prevailing view at Tricontinental was that SBV stood behind Tricontinental, and that SBV's capital base was available to Tricontinental in
determining the size of Tricontinental's exposure to individuals and groups. Johns had confirmed this to him.

15.202 As to the implementation of the policy, Moyle said that Johns, McAnany and he had discussions that went on for "quite a long period", from "about the middle of 1986 and through the second half of 1986". He said that "the important point of a lot of these discussions was to achieve the sharing of information" necessary for the management of group exposure levels. The details to be shared were set out in Moyle's statement to the Commission.

15.203 At the SBV level, Moyle and McAnany wrote a memorandum to SBV Commissioners, dated 16 October 1986, dealing with SBV's prudential exposure guideline limits. The memorandum said in part:

"At present, we have no formally approved guideline limits on a Group basis but, naturally, exposures relating to Tricontinental Holdings are taken into account when assessing the particular levels of exposures being considered by the Bank for a company, group etc. This matter, as well as the basis of structuring PEGLs [Prudent Exposure Guideline Limits], are currently under review (in conjunction with Tricontinental Holdings) for early submission to the Board."

15.204 SBV commissioners began to see evidence of the implementation of the aggregated loan exposure policy from early 1987. In answer to a question regarding his knowledge of Tricontinental's individual loan exposures, Mr Renard said:

"I knew that from early 1987 onwards, State Bank officers in the corporate banking department had a full knowledge, so far as I could perceive, of the identities of the Tricontinental borrowers, the types of loans or exposures, and the amounts drawn down under them, and the total exposures including undrawn amounts. I say that, because the facts from early 1987 onwards, appeared regularly in State Bank credit submissions."

15.205 A memorandum from Johns to Ziebell, dated 17 February 1987, dealt with both the adoption and implementation of an aggregated loan exposure policy. It stated that:
"Mr Moyle has requested that in the paper being presented to the board [concerning Tricontinental's operating guidelines], that we firstly acknowledge that lending limits will need to be aggregated with those of the State Bank of Victoria and that Tricontinental proposes to contact the assistant general manager, corporate loans, State Bank of Victoria to verbally acknowledge all and any approvals in excess of $10m per client, State Bank of Victoria shall also do the same with myself.

A paper is to be included with TCL’s board papers on a monthly basis with exposures for approval at that board meeting with exposures in excess of $10m which is to incorporate facilities provided by State Bank of Victoria.

I have stressed to Moyle that this information sought is only to be between myself and the assistant general manager, corporate loans, State Bank of Victoria and is not to be in writing or kept on respective files.

No doubt we shall draft suitable paper later this week."

15.206 The minutes of the next board meeting, on 25 February 1987, do not refer to the aggregation of Tricontinental and SBV loans within a single exposure limit, but the board papers contained a report, dated December 1986, in the administration section, under the heading "Credit Submissions", which noted that:

"Tricontinental’s lending limits will be aggregated with those of the State Bank of Victoria and Tricontinental will contact the assistant general manager, corporate loans, State Bank of Victoria to verbally acknowledge all and any approvals in excess of $10m per client. State Bank of Victoria shall also do the same with Tricontinental.

The paper included with Tricontinental’s monthly board papers on exposures for approval will, for exposures in excess of $10m, incorporate facilities provided by State Bank of Victoria.

The information flow between State Bank of Victoria and Tricontinental will not be in writing or kept on respective files."

15.207 The prudential policy of measuring Tricontinental’s individual loan exposures against SBV’s capital base was expressly referred to in Australian Ratings reports. The report regarding Tricontinental, dated May 1987, under the heading "Rating Rationale", stated that:

"Asset growth has been achieved through the acceptance of a number of large secured exposures, particularly to unlisted entrepreneurial companies, and while individual exposures are large viz a viz the company’s equity base, we understand acceptable margins of cover
have been maintained. While Tricontinental's management operates autonomously, loan exposures are managed within a Group limit system and should be measured relative to the State Bank's $439m equity base."

The Australian Ratings report dated February 1988 stated that:

"In achieving the rapid growth over the last two years Tricontinental has created a number of large individual exposures, relative to the equity base. Exposures are, however, managed on a group basis, and should be viewed in the context of the State Bank group's equity base ($527m). On this basis, no individual exposure is unduly high in terms of the SBV group equity base."

At its meeting on 24 February 1988, the board discussed Tricontinental's capital adequacy. Moyle noted that "this was an appropriate time for conservative views in the light of the current economic climate", but as discussed later in this chapter, the board decided not to include in the guidelines a limit on lending to any one client or client group. However, the board did agree to continue "the existing arrangement between Mr Johns and Mr Moyle", which, of course, was a reference to a limit of 20% of the SBV group's capital base, which had been about $100m at the time the arrangement was made.

Attachments 22H to 22K of the first report show that during the years 1986 to 1989 more than 90% of all new and increased loan facilities were approved by the directors, as distinct from approvals by lower levels of delegated authority.

Attachments 22C-D and 22G of the first report list Tricontinental's largest exposures in each of the years 1986 to 1989. In summary the numbers were as follows:

<table>
<thead>
<tr>
<th>Over $200m</th>
<th>31.5.86</th>
<th>28.7.87</th>
<th>30.9.88</th>
<th>31.3.89</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over $150m</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Over $100m</td>
<td>3</td>
<td>5</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Over $60m</td>
<td>3</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
</tbody>
</table>
It is difficult to reconcile the figures in this table with the arrangement about maximum exposure to clients. Indeed, by 31 March 1989 the top 16 exposures totalled $2,001m. The smallest of them was $63m.

Tricontinental’s largest loan exposures even exceeded the prudential limit of 20% of the SBV group’s capital base. When measured against the total capital of the group as shown in SBV’s financial statements - which was the measure of capital used by SBV in reporting its large exposures to the Reserve Bank in 1986 and 1987 - there were four loan exposures in excess of the 20% limit as at 30 June 1986 (the largest being 43.3%), three as at 30 June 1987, and five as at 30 June 1988. In his evidence, Mr Moyle said that the appropriate measure of capital was that used for capital adequacy reporting purposes, which included other amounts in the measure of capital (such as asset revaluations not recorded in the financial statements). This measure of capital was used by SBV for reporting its large exposures in 1988. Even on that basis, and using SBV methodology to measure group exposures, there were four exposures in excess of the limit as at 30 June 1986 (the largest being 38%), one as at 30 June 1987 (23.5%), and three as at 30 June 1988.

The Commission makes the following findings about the size of Tricontinental’s loan exposures:

(i) Attempts by SBV senior managers - Mr McAnany and Mr Escudier - to limit the amount of lending by Tricontinental to any one client or client group, were quashed by Mr Moyle. Their proposals were never brought to the notice of the SBV board.

(ii) In July 1986, Mr Moyle agreed with Mr Johns that Tricontinental could not function effectively as a merchant bank lender unless it could then make up to $100m available on a secured basis to a client group. This was approximately equivalent to 20% of SBV’s then capital base - the limit which SBV applied to its own commercial lending.

(iii) This approach was discussed at the July Tricontinental board meeting and was approved in principle. The precise terms of the approval are
unclear because they were not recorded.

(iv) This arrangement or understanding was never brought to the notice of the SBV board.

(v) Nor is there any evidence that the proposed limitation was ever applied in practice.

(vi) In fact, Tricontinental had already advanced more than $100m to several clients, and did so to a much greater extent later - see the table in para 15.211 above.

(vii) Mr Moyle was in a situation of some conflict, as between SBV and Tricontinental, although there is nothing in the evidence to suggest that he saw it in those terms.

(viii) The Commission can but wonder if the course of events might have been changed, if Mr Moyle had consulted his SBV board fully about the limits of Tricontinental’s lending. Unfortunately that line of thought can be no more than speculation, but it does point up the crucial nature of Mr Moyle’s attitude in mid-1986. That, of course, was the time of his maximum confidence in the abilities of Mr Johns.

(ix) Effective steps were not taken by either the board or management to reduce the concentration of Tricontinental’s lending resulting from its large exposures to particular borrowers.

(x) This was not simply a failure of the board to direct and monitor the performance of management. As noted in para 15.210 above, more than 90% of all new and increased lending was expressly approved by the directors themselves. That approval occurred under the round robin procedure for the consideration of credit submissions.

15.214 The Commission finds further that:

(i) Had the limit of $100m set in July 1986 been observed, and maintained at that high level (including the refusal of extensions of existing facilities beyond that amount), the losses suffered by Tricontinental would have been substantially less.
(ii) It is arguable that Tricontinental might have made smaller loans to a greater number of clients, to arrive at the same total amount of lending, and the same total of losses, but this is highly unlikely. One of Tricontinental's besetting problems was its apparent inability to deny the requirements of its major clients. It was much more likely to look critically at new borrowers.

(iii) Had the maximum size of Tricontinental's loans to any one borrower been limited to a prudent proportion of its own capital base, as distinct from SBV's capital base, there would have been a dramatic reduction in the total of its losses. The losses realised might have been only ten per cent of those actually incurred - if the limit of 20% of its own capital base, and the proportion of loss to volume of lending actually experienced, are assumed. Mr Johns and Mr Moyle argued that such a constraint on lending would have made Tricontinental unworkable as a merchant bank. In so far as that meant unworkable in terms of the 'high risk for high reward' lending strategy, that would not have been a bad thing. But the limitations imposed need not have been as strict as those suggested by Mr Escudier and Mr McAnany.

(e) Limits to delegated credit approval authorities

15.215 Tricontinental's lending guidelines contained two major elements. First, authority was delegated to directors and executives, both individually and collectively, to approve credit facilities up to specified limits. Secondly, the substantive lending guidelines were set out.

15.216 The delegated credit approval authorities were reviewed by the board from time to time.

15.217 The holders of delegated authority, in ascending order, were assistant general managers, general managers, the credit committee, the group managing director, two directors, and "four directors including the group managing director or all available directors on the day". The guidelines did not specify
any monetary limit for credit approvals by the four directors or those available on the day. The limits applicable to the other levels of delegation, and the changes made from time to time during the period December 1984 to May 1989, are summarized in attachment 22B of the first report.

15.218 The only particular change that needs to be noted occurred in February 1987. Moyle had indicated to Johns that he would support an increase in the managing director’s discretionary limit for secured facilities from $3m to $10m. (The $3m limit had applied since at least December 1984). The board, however, at its meeting on 25 February 1987 was only prepared to increase the managing director’s discretion to $6m. Ryan was opposed even to that increase. In early 1989 Ryan again expressed the view that Johns’ discretion limit was excessive, but he received no support (see para 15.49 above).

15.219 Minutes of the board meeting on 16 December 1987 note Rawlins’ concern that "material changes to existing facilities could be approved without approval of all directors, and that possibly a select group of directors should be charged with this responsibility". He asked that a paper be tabled at the next meeting.

15.220 At the board meeting on 27 January 1988 Johns tabled a summary of existing delegations and procedures. As had been the case since at least December 1984, they included a requirement that "all credit submissions already approved between meetings be submitted to the board meeting for formal confirmation". Johns suggested that the system worked efficiently and effectively, and that there appeared to be no real need to change it. The board agreed to retain the existing system.

15.221 The Commission makes the following findings about the limits to credit approval authorities:

(i) Nothing of substance turns upon the levels of delegation or the limits to the approval authorities granted, below the level of four directors.
(ii) It is noted that Mr Ryan objected to the increase in Mr Johns' discretion as managing director in February 1987, and again voiced his concern in early 1989. However, Mr McAnany - regarded as a holder of conservative views - stated in evidence that he had no objection to Johns' limit of $6m in itself.

(iii) The real point was not the fact of delegation, but the way in which the discretions were exercised by Mr Johns up to $6m, and by the directors over that amount.

(iv) As to the delegation to four directors "or all available directors on the day", the obvious feature is that no limit to their approval authority was specified by the lending guidelines.

(v) The absence of a limit might not have been so significant, but for the fact that over 90% of new and increased lending approvals (by dollar amount) were approved by two, three or four directors (or more on rare occasions) on a round robin basis.

(vi) The freedom of directors (mostly with limited relevant experience) to approve credit submissions for the lending of amounts over $6.5m, without the advantages of meeting and exchanging views and together checking matters with the relevant executives, was a serious weakness in the system.

(vii) That weakness was aggravated by two further factors. First, the directors were not particularly inhibited by the arrangement for a lending limit of 20% of SBV's capital base; see first report, attachment 22G. Secondly, the submission of approvals to the next board meeting for 'formal confirmation' was treated, apart from occasional discussions, as no more than a noting exercise. Indeed it could be nothing more, for the initial approvals were decisive and were acted upon.

(f) Substantive lending guidelines

15.222 Tricontinental had formal guidelines for the operations of the various divisions of its business. These included lending, underwriting, investment banking,
investment funds, treasury and foreign exchange. In addition, guidelines dealt with gearing, signatories, purchase of capital equipment, sundry aspects of staff activity and administration, and matters relating to Tricontinental Futures Pty Limited.

Operating guidelines (or divisional guidelines, as they were also called) existed before November 1984 in the form of statements approved by the board from time to time, and memoranda prepared or approved by the managing director. In November 1984 this material was brought together, presented in a systematic manner, and approved by the board. The resultant statement of guidelines then applied to the conduct of Tricontinental's operations until May 1989, subject to modifications and additions that were approved by the board on several occasions.

As discussed in chapter 11 of this report, the lending guidelines did not incorporate any mandatory requirements to obtain all information required for the proper assessment of the credit risk before approval, nor for identifying and objectively evaluating the nature and degree of credit risk. For that matter, there was no guidance as to the nature and degree of credit risk that Tricontinental was prepared to accept, other than the ratios for loan-to-security cover for the various types of loans.

The divisional guidelines approved by the board were not the only statements of policy or procedure. As noted in chapter 11 of this report, management produced manuals for credit, security and treasury operations. These were concerned mainly with procedural matters, and were not approved or reviewed by the board.

The credit procedures manual provided guidance for junior analysts as to the principles of credit risk evaluation, types of information to be presented in a credit submission, a description of standard loan conditions and covenants, and details of policies which Tricontinental usually followed in evaluating and
structuring loans. The extent to which these procedures were observed is discussed in chapter 11.

15.227 There were also undocumented policies and procedures. These are also noted in chapter 11. They included the arrangement for maximum loan exposure to an individual client group, and the testing of a client's ability to service a loan by reference to a benchmark 20% per annum. Again, the extent to which these non-documented procedures were observed is another matter.

15.228 Some care is needed when considering evidence in which statements are made about "guidelines", particularly statements by the more junior managers and analysts. It is not always clear whether they were referring to the operating guidelines approved by the board, the various procedure manuals and other memoranda put out by management, non-documented but well known policies and procedures, or a combination of some or all of those matters.

15.229 Attention is focused here upon the operating guidelines for lending which were approved by the directors on several occasions, and in particular upon the responsibility of the directors for the existence, content and application of those guidelines. Three main aspects of lending were covered by them:

- delegated loan approval authority limits (these have already been discussed in the preceding section of this chapter)
- basic terms and conditions for lending, including covenants and pre-conditions to drawdown
- security requirements.

15.230 In November 1984 the guidelines dealt with lending for construction, lending secured by debenture charges on assets, lending for shares, loans denominated in a foreign currency ("lending for eurocurrency loans"), and lending for real property. Modifications or additions were made to each of those categories after 1984. Changes were also made to related provisions for delegated credit
approval limits, the constitution of the credit committee, and reporting arrangements.

When considering the responsibility of the directors, several questions arise:

• Did the directors ensure that the lending guidelines were adequate?
• Did they expect management and staff to observe the guidelines?
• Did the directors themselves observe the guidelines?

Each of these questions is discussed below.

(i) Adequacy of the lending guidelines

Attachment 22A of the first report sets out in full the lending guidelines as they stood in May 1989. It is convenient to refer to the guidelines in that form, but it is also necessary to be aware of changes proposed between 1984 and 1988, particularly in the case of lending secured by shares.

At the meeting of the board on 20 October 1984 Mr Keller, an alternate director representing the shareholder Security Pacific Bank, asked whether Tricontinental had lending guidelines, and whether there was a maximum amount to be committed to any one client. The reply by the managing director, Mr Redenbach, was that guidelines had been minuted many years ago, and that they provided for a maximum exposure of $10m per client. Mr Keller observed that the $10m maximum appeared too low. Mr Hancock, present as an alternate to Mr Smith as a representative of SBV, suggested that due to industry changes there should be a review of the guidelines. The board agreed that a review of the lending guidelines and the maximum exposure per client should be undertaken and presented to the November meeting.

At the meeting of the board on 8 November 1984 the managing director's report contained a review of lending guidelines. After stating a view as to Tricontinental's future lending policy (which has already been discussed earlier in this chapter), the review set out the "present lending criteria of
management", which "of course, carry the necessarily sensible flexibility engendered by the market place".

15.235 The review listed the criteria for lending for construction, debenture charge, shares, eurocurrency, and real property. Then followed the heading "Recommendation for maximum exposures". It was argued that in an era of deregulation, merchant banks limited to $5 -$10m lines would not survive. A new approach to exposure limits was proposed.

15.236 For unsecured lending the recommendation was in the following terms:

"There will always be exceptions to guidelines, however generally it is recommended that unsecured commitments be limited to 20% of the clients' total shareholders' funds with a maximum exposure of $15 million. An automatic exception to this guideline would be statutory bodies, trading banks, and multinationals, where parent support will require greater emphasis."

15.237 For secured lending, it was recommended that "Tricontinental continue with its secured lending policy as at present, with each and every proposal assessed separately on its own merits." In order to assess Tricontinental's "true element of risk" per transaction or aggregate of exposure to any one client, it was proposed that a formula be adopted. A "maximum risk value" (MRV) was to be calculated. It was equivalent to 30% of the "lending value" of the security, and represented the largest loss that could reasonably be envisaged if a security had to be realized. It was recommended that the MRV for any single facility, or aggregated exposures to any one client, be limited to $20m.

15.238 It followed that if the MRV could not exceed $20m, then the amount of any secured loan (of which $20m was 30%) could not exceed $66.6m. It then followed that a credit submission would not be acceptable if it proposed a secured loan of more than $66.6m.

15.239 At the November 1984 meeting the board agreed to "the guidelines and the client maximum lending exposures" set out in the board paper.
In fact the MRV became something of a dead letter. Although it was intended to be set out in credit submissions, it does not seem to have carried any weight in the approval process. A reference to the MRV calculation (with an example), together with a statement of the $20m limit, appeared in later editions of the lending guidelines, but it was eventually deleted in the edition dated January 1988. In practice there was no maximum limit derived from the lending guidelines. As discussed earlier in this chapter, the real constraint was imposed by capital adequacy problems.

The three year plan adopted by the board in May 1986 referred to the lending guidelines in the following terms:

"The [lending] division prides itself in marketing the concept of assessing all proposals on their own merits - no rigid guidelines are in force and this allows managers to be innovative and commercial in their approach to financing."

As noted earlier in this chapter, the plan proposed a "serious and deliberate" pursuit of "proposals with predictable manageable risk, offering exceptionally high revenue/return opportunities", and the majority of new business was to be generated from lending for property/construction, equities, mining and tourism.

The minutes of the meeting on 28 May 1986, at which the plan was adopted, noted under the heading of credit submissions that - "In response to a question the Managing Director assured the Board that all submissions tabled were within the various internal guidelines and policies." It is not clear whether Johns was speaking generally, or only about the specific submissions then tabled.

At the May meeting, a request was made for a summary of the "internal authorities and guidelines" to be available at the next board meeting. The guidelines were presented to the June 1986 meeting as requested. The minutes record the following:
"The Managing Director led the Board in a discussion on Tricontinental's Internal Operating Guidelines as set out in the attached booklet.

The Board advised of a number of discrepancies within the booklet and Mr Rawlins advised that the Guidelines relating to Futures and Interest Rate Swaps should not relate to downside margins but should be tied to rate movements.

Mr Rawlins also queried the Money Market guideline concerning movements in asset size and was advised that this was in place to monitor balance sheet size and gearing as well as monitoring the direction and strategy of the Group's corporate funding."

It would seem that the board took a close interest in the contents of the guidelines at that time. On the material available, the Commission is unable to say what the "discrepancies" were, or whether anything was done about them. It seems likely that attention was focused on guidelines for operating divisions other than lending. Certainly nothing appeared in subsequent publications of the guidelines that attributed to that meeting any change of the lending guidelines.

15.244 Lending described in the guidelines as "lending for shares" is more accurately described as lending secured by shares. There were several types of transactions, as described in evidence by Mr Hancock. One was lending for the purpose of buying particular shares, and relying largely on those shares for security. A second was lending for investment, on the security of shares which the borrower already owned. A third was lending to a company for its development, on the security of shares in a related company.

15.245 According to Mr Hancock, the wisdom of taking shares as security depended upon the quality of the shares and the margin between the value of the security and the size of the credit facility. Although Tricontinental’s lending secured by shares was sometimes described as margin lending, the expression was often misused.
15.246 In margin lending, the lender looks to the parcel of shares purchased with the loan as providing both security for the loan, and the source of funds for repayment of the loan. In evaluating a margin lending proposal, the lender does not evaluate the ability of the borrower to service or repay the loan. Instead, total reliance is placed on the use to which the loan is put: the purchase of the shares. Since no credit evaluation of the borrower is undertaken, the success of this type of lending depends critically upon the quality and marketability of the shares purchased with the loan. The evaluation of the shares purchased must, therefore, be very thorough and exacting.

15.247 The criteria for lending on the security of shares, approved by the board in November 1984, were short and simple:

"The current market price of the shares must at all times give a predetermined times cover of the amount drawn under the facility.

- Industrial shares - times cover 1.3
- Mining shares - times cover 1.5

A share register is kept whereby the daily price of all shares held is recorded to ensure the required times cover is maintained.

If not maintained the facility must be reduced, a cash deposit lodged or additional acceptable security obtained."

15.248 Those guidelines were reviewed in February 1987. Moyle asked Johns to provide a board paper detailing Tricontinental's policy on the acceptance of publicly listed scrip as security, and Johns asked Mountford and Stott to prepare the paper. The response was included in the managing director's report to the board meeting held on 25 February 1987.

15.249 The relevant section of the board paper was headed "Lending Guidelines - Public Listed Companies". It stated - "In view of the sustained bull market and potential volatility, directors are provided with an update of current policy and guidelines". Presumably the state of the market had prompted Moyle's
request. The material set out was in fact a considerable advance on the simple security ratio provisions last approved by the board in November 1984. So far as the Commission has been able to observe, it was also a considerable overstatement of existing lending practices. The guidelines proposed in the paper were as follows:

"(A) Lending Guidelines

The current market price of shares held / offered as security must at all times provide a pre-determined times cover of the amount drawn under the facility. As a general guide, TCL requires minimum cover:-

- Industrial shares - times cover 1.3 times.
- Mining - times cover 1.5 times.

Any variations to times cover (as above) is considered (submission stage) with due regard to any combination of the following factors:-

Increased Cover Required

1. Scrip offered is assessed as of a speculative nature.

2. Percentage of issued capital offered as security is deemed high in relation to capacity to immediately sell down within a short time frame (say 15% plus). An exception is strategic parcels of industrial or quality mining scrip.

3. Borrowers financial capacity to provide immediate top up cover (in relation to level of borrowing) from liquid resources, is not clearly visible.

4. Concerns re. asset backing / assessed prospects to market price (as in 1 above).

5. Lack of past profit record and dividend income stream of shares offered as security.

A substantive segment of portfolio reflecting combination of these aspects have been written at 1.8 to 3.0 times minimum cover.
Lower Cover Required

1. Financial standing of borrower and capacity to provide top up cover is not in question, eg. net worth ex. scrip held is $10 million plus.

2. Take out is assured from sources divulged and assessed as satisfactory at time of loan approval, eg. Assignment of Underwriting Agreement (to TCL) from a reputable broker re. proposed new share issue and / or put option from a reputable 3rd party.

(B) Security Requirements

Prior to facilities being made available, TCL is to be provided with :-

1. First registered share mortgage over shares purchased / offered as security.

2. Lodgement with TCL of the share scrip referred to above together with signed blank transfers.

3. Supporting guarantees, as appropriate.

Please note

1. & 2. above are to be provided in a form and substance satisfactory to TCL's legal advisors so as to ensure that TCL is in a position at all times to immediately effect a sale of scrip in the event loan pre-conditions or covenants are breached.

(C) Monitoring Controls

A share register is maintained and updated daily to record the previous day's last "buy" price and to ensure the required times cover is maintained. When the market is volatile, position is monitored at regular intervals during daily trading. In the event that minimum loan cover ratio is not maintained, borrower is required to lodge a cash deposit or additional security acceptable to TCL - time frame is 24 hours to 3 days (max.) dependent upon credit worthiness of client. Break up by industry classification is also monitored together with holding in a specific company (aggregation of a spread of borrowers).

For facilities extended as trading lines (scrip not designated from the outset) authority to accept scrip offered is restricted to Group Managing Director, General Manager Lending or in their collective absence, Assistant General Manager Credit.
As a general policy (with few exceptions) clients are not permitted to gear up on increased market values, subsequent to loan drawdown.

After some discussion, further consideration was deferred to the next meeting, held on 25 March 1987. The minutes of that meeting state:

"The Managing Director advised [the] Board of Tricontinental's current practices and policies in this regard and gave certain assurances as to the cover required and the monitoring of the cover.

The Directors agreed that they were comfortable with the security ratios outlined in the paper and noted the Managing Director's advice that the sum of all client's security exposure to any one company cannot exceed 5% of that Company's issued capital.

The Board further noted that exceptions would exist to the 5% limit e.g. take-overs.

The Board asked that a schedule of all lending against shares be provided on a quarterly basis."

The statement of the lending guidelines dated January 1988, and later statements, incorporated the provisions approved by the board on 25 March 1987. They were as set out in the board paper, but amended to give effect to the above board minute. Thus a paragraph was added at the end of the section headed "Monitoring Controls" as follows:

"4. At a meeting of Directors held on 25 March 1987, it was decided that maximum security exposure to any one company was not to exceed 5% of that company's issued capital. It was acknowledged that there would be exceptions to this limit and it was resolved that a schedule of all lending against shares be presented to the board on a quarterly basis."

A consequential amendment was made in para 2 of the section headed "Increased Cover Required", where "5%" was substituted for "say 15% plus" of issued capital.

The evidence before the Commission is not clear as to whether the provisions approved in March 1987 were made available to managers and staff before publication of the consolidated guidelines dated January 1988. Commission
staff have been unable to find any consolidated guidelines published between those dated June 1986 and January 1988. That leaves unanswered the question whether effect was given before January 1988 to the modification imposed by the board in March 1987.

An addendum to the three year plan was put to the board meeting on 27 May 1987. Under the heading of the future direction of lending, it was proposed that Tricontinental would - "Maintain a high measure of flexibility within established guidelines which are regularly revised in the light of loan demand and economic outlook". This may be compared with the statement in the three year plan in 1986 that "no rigid guidelines" were in force.

The bull market in shares that had been brought to the board’s attention in February/March 1987 continued until the sudden collapse of the stock market on 20 October 1987. According to Stott, at that time approximately one-third of Tricontinental’s loan portfolio was secured by shares.

At the board meeting on 18 November 1987, soon after the stock market crash, the managing director’s report noted that "with the entrepreneurs having suffered massive paper losses which in turn have highlighted cash flow problems within their empires, the markets have focused on credit risk". As a result of the dramatic fall in equities, Tricontinental was monitoring stock markets three times daily, and the position of clients with borrowings secured by equities was monitored daily. Johns assured directors that all clients to date had provided top up securities, except for seven named corporations or groups which did not cause him any immediate concern. (These included corporations connected with Mr Herscu and Mr Skase.)

Evidence referred to elsewhere in this report shows that Johns was not being frank in what he said about the numbers in default, or about whether there was cause for concern.
Counsel assisting the Commission submit that there was a fatal optimism behind lending for shares. They submit that Johns, the credit committee, and directors who approved credit facilities, failed to focus upon the quality of the shares taken as security, the amount or proportion of shares taken as security, and the underlying net assets of either the borrower or the company to which the shares related.

In evidence Stott said that the primary means of assessing the adequacy of shares as security was to look at the share price movements over the last two or three years to ensure that there had not been large fluctuations in the share price. Johns believed that Tricontinental relied upon the market value of the scrip held as security, not its net asset backing. The possible connection between the two considerations was apparently not thought to be important.

In evidence Johns said that he had not been overly concerned at the fact the share market was very high for some months before the October crash. It was a bull market phase and Johns knew there had to be a correction at some time. He didn’t believe anyone thought there would be a crash to the extent there was. Mr Johns said - with a touch of exaggeration - that shares "across the board dropped about 50% in value overnight". Johns said he was disappointed that, apart from Smith, he had very little moral support from the board of Tricontinental immediately after the stock market crash. He said that they all knew of Tricontinental’s involvement in the equities market and the extent of its lending against equities. Stott said that, after October 1987, there were not many new loans with shares as security, but there were certainly extensions on existing ones.

A bizarre example of what could occur under the guidelines on lending secured by shares is contained in the report presented to the March 1988 board meeting. Among clients who had failed to meet calls for top-up of security cover at that stage was one in the following position - "Facility $17m is
secured by a variety of small first and second board stocks, with market value $5.1m. Cover required 1.4 times. Deficiency $18m."

15.261 At the board meeting on 16 December 1987, Johns informed directors that he was amending security arrangements, and taking mining leases in some cases instead of equity scrip. This prompted Rawlins to ask for a paper at the next meeting on recommendations for an overall limit on mining leases accepted for security for lending facilities, as he thought the leases could prove to be of little value. Rawlins also asked for a full list of loans in default where clients had not maintained security values for lending secured by equities. Further, he expressed concern as to whether material changes could be made to existing facilities without approval by directors, and asked for a paper on that at the next meeting.

15.262 At the board meeting on 27 January 1988, which Mr Rawlins did not attend, a number of lending guideline matters were considered. In response to Rawlins' query at the previous meeting about mining leases, the board accepted a recommendation to limit Tricontinental's exposure to the greater of $300m or 7% of total lending commitments. The Commission notes that this decision did not find its way into later editions of the lending guidelines, which is curious, given Johns' statement in December 1987 that he was proposing to take mining leases as security in some cases instead of equity scrip.

15.263 In response to Rawlins' query about delegated approvals of credit submissions, a board paper reproduced the guidelines on this topic (last considered on 25 February 1987), and submitted that, as the existing system worked efficiently and effectively, there appeared to be no real need for change. The board agreed to retain the existing system. The vital question raised by Rawlins, concerning Johns' authority to vary loan terms approved by directors, seems not to have been considered.
The minutes for the January meeting record that Johns "led the board in a discussion on the Divisional Guidelines as set out in the Board papers and Mr Moyle asked that the guidelines be deferred until the February, 1988 Board Meeting".

Mountford had sent to Ziebell a memorandum dated 18 January 1988, that "recommended" the following variations or additions to the lending guidelines:

- **Lending for construction**
  - the limit of lending the lesser of 70% of 'on-completion' valuation or 80% of total construction costs, to be made subject to exceptions approved by the board
  - the requirement of firm lease commitments and/or presales of an acceptable area prior to drawdown, to be made subject to exceptions approved by the board for projects constructed in prime CBD locations

- **Lending for debenture charges**
  - the limit of lending against 70% of the written down value of assets to be tightened by excluding debtors in excess of 60 days (compared with 90 days)
  - further requirements to be included concerning details of debtors, and provision of reports by borrowers

- **Lending for shares**
  - times cover to be increased:
    - Industrial shares from 1.3 to 1.5
    - Mining shares from 1.5 to 1.8
  - paragraph to be added after the above:
    "Following severe market downturn (October 1987) Tricontinental generally requires higher than minimum cover and/or the capacity to meet margin calls is clearly demonstrated prior to loan availability."
Johns sent to Ziebell a memorandum dated 18 January 1988, in response to a memorandum from Ziebell about "draft" divisional guidelines, and "advised" changes which included the following - "In relation to lending for real property, page 8, reference to 65% should be amended to read 65-80% dependent upon financial standing of borrower and location of property etc."

The memorandum also stated that Johns would advise Ziebell in due course about foreign exchange dealing limits.

At the board meeting on 24 February 1988 Johns again led a discussion on the divisional guidelines which were presented with the board papers. The minutes record the following:

"Mr Moyle advised that this was an appropriate time for conservative views in light of the current economic climate. However due to the matters presently under development it was agreed that the Guidelines would not be amended however in regard to Lending limits the existing arrangement between Mr Johns and Mr Moyle will continue." (Commission's emphasis)

The above minute could be construed as meaning that the amendments proposed by Mountford and Johns were not accepted by the board. Given that it was "an appropriate time for conservative views" it is understandable that proposals to facilitate expanded lending would be rejected, such as Mountford's proposal for exceptions from the construction guidelines, or Johns' proposal for lending on an increased percentage of the valuation of real property. It is less understandable that a proposal to tighten lending would be rejected, such as Mountford's proposals for assessment of assets in debenture charge lending and, most significantly, increasing the minimum times cover required for lending on shares.

The fact is, however, that a statement of lending guidelines dated January 1988 was published under Johns' name and the changes proposed by Mountford and Johns were included. Indeed, the guidelines on lending for real property changed the maximum loan to security ratio from 65% to a range of 65% to 85%, compared to the range of 65% to 80% proposed in Johns'
memorandum. In contrast to that expansion, the provisions on lending for eurocurrency loans were tightened to require top-up on a 5% foreign exchange rate fluctuation within 48 hours, compared to the previous requirement of 10% and 7 days. As noted previously, the guidelines also deleted the provision which limited lending to a maximum risk value (MRV) of $20m.

Further, the statement of lending guidelines included the following additions on the subject of reporting:

- Monthly board meeting to receive reports of lending by industry classifications and operational classifications, and reports of lending secured by equities.
- Quarterly board meeting to receive reports of top 20 clients, and equities security exposure

The variations and additions which appeared in the statement of lending guidelines dated January 1988 were repeated in the statements dated June, July and December 1988, and in the submission dated 18 January 1989 made by Tricontinental to the Reserve Bank.

The Commission's files include several memoranda (not exhibited) dated 25 February 1988 (that is, the day after the board meeting) from Johns to Russel Shaw, referring to the guidelines for trading in futures and foreign exchange. One of the memoranda stated:

"As you are aware, TCL's current guidelines were discussed at the February Board meeting and were re-endorsed by the Directors. I remind you that the futures limits for trading are ... [the limits were set out] ... As you were given the opportunity to review and amend all guidelines at our recent Group Management Meeting, and I did not hear from you, they were placed before the directors as they were."

A likely basis for reconciliation of the minute of the meeting on 24 February 1988 that "the Guidelines would not be amended", and the publication of amended guidelines dated January 1988 that included the amendments proposed in January and discussed in February, is that the February minute
unwittingly telescoped two separate topics concerning the lending guidelines. One topic was the amendment of the guidelines as proposed by management in January. The other topic was a separate issue which Moyle raised at the February meeting relating to lending limits for the purpose of ensuring capital adequacy. The minute should have read ‘... the Guidelines as tabled would not be further amended ...’.

A strong pointer to this distinction lies in the reference in the February minute to "matters presently under development" and "in regard to lending limits the existing arrangement between Mr Johns and Mr Moyle will continue". Reference to the handwritten notes taken at the meeting by Ziebell show that the discussion of lending guidelines took place in the context of repeated comments at the meeting by Moyle about Tricontinental’s capital adequacy, Reserve Bank pressure, and the need to address capital adequacy in future financial plans. After referring to those comments, Ziebell’s notes then read - "Guidelines - appropriate time for conservative view - Lending - no per client lending - With Lending limits leave as informal discussion between IMJ and Bill Moyle over the next 1-2 mths until Tricontinental future is resolved". This note appears to indicate a discussion about incorporating into the guidelines a maximum limit on lending to any one client or client group, as distinct from the existing situation of no express dollar limit on "per client lending". The note also appears to indicate agreement not to impose a limit for the time being, but to continue to rely upon the existing arrangement between Moyle and Johns that Tricontinental would not lend more than an amount equal to 20% of SBV’s capital base, and that Tricontinental would continue to consult with SBV to ensure that Tricontinental and SBV together would not exceed a limit of 20% of SBV’s capital base in lending to common clients. The deletion of the MRV limit of $20m at that time is consistent with this approach.

On the material available, the Commission is not able to take this matter any further, but in the circumstances it accepts as almost certain that the
amendments to the lending guidelines attributed to January 1988 were in fact approved (or at least noted) by the board in February, despite the terms of the minute relating to guidelines recorded at the meeting on 24 February 1988.

15.276 Apparently further consideration was given by management to prudential limits in lending. At management meetings on 19 April 1988 and 6 June 1988 Mountford stated that he was preparing a paper. The Commission is unable to say what gave rise to this consideration, or whether anything came from it at the time, but Mountford did produce a paper twelve months later.

15.277 This paper had its origin at the board meeting on 26 April 1989, to which reference has already been made in para 15.155 above. By memorandum dated 5 May 1989 Johns sought Mountford's views on proposed changes to credit policy. He said, "Directors are seeking a complete re-assessment of credit policy which is to be discussed at the next Board meeting ...".

15.278 Mountford replied to Johns by memorandum dated 14 May 1989. He suggested specific amendments to the lending guidelines in response to the changes sought by the board. The points raised are significant. They included:

(i) Lending for construction - a requirement that all necessary approvals, permits etc. be in place before drawdown; but interest might be capitalised not only for the construction period (as before) but also a reasonable letting period, up to 6 months.

(ii) Lending for debenture charge - more extensive and stringent covenants, and all applicable to public as well as private companies; nil value attributed to work in progress, raw materials, plant and equipment.

(iii) Lending for shares -
- minimum times cover increased from 1.8 to 2.0 times in the case of mining shares (industrial shares unchanged at 1.5 times);
- shares or options not acceptable if unlisted, or listed but held in escrow;
increased cover required if the company in which the shares are held is listed on the second board of a stock exchange, if there is unsatisfactory shareholder spread or thin trading, or if there is unfavourable industry performance or outlook;

lower cover required (as before) if takeout assured, but if by underwriting agreement there must be provision of an adequate margin to cover a fall in the All Ordinaries Index, say 20% as a general rule;

security requirements before drawdown to include a deed of set-off over cash lodged, for top-up requirements (this would obviate the possible need to obtain a deed at a later date);

as a general policy (with few exceptions) a request for release of scrip held as security in the case of increased market value must be made in writing, with a cooling off period of two weeks before release;

credit facilities will not be provided as trading lines (scrip not designated from the outset); deletion of authority of managing director or general manager lending to accept scrip offered on a trading line.

(iv) Lending for real property

maximum 75% of independent valuation for mortgage purposes (in place of existing 65-85%).

By memorandum dated 16 May 1989, Johns circulated to all Tricontinental directors proposed guidelines for comment, in response to the request made at the April meeting. Presumably these were Mountford's suggestions. The proposal came to nothing as the SBV board meeting on 21 May 1989 integrated Tricontinental into SBV.

Nevertheless, the proposals put forward by Mountford are enlightening. They serve to indicate what he then perceived to be points where change was appropriate, when pressed by the board to reassess and tighten lending policy.
In fact, the proposals by Mountford were a rather restrained response to the anxiety shown by Ryan and the suggestions made by Moyle.

Tricontinental’s submission dated 18 January 1989 to the Reserve Bank claimed (at para 4.51) that the existing operational and risk management guidelines were comprehensive, and that the operational guidelines were regularly updated.

The Commission makes the following findings as to whether the directors ensured that the formal lending guidelines were adequate:

(i) The guidelines were sparse. They covered a bare eight pages, of which two pages set out the limits to the credit submission approval authorities, and six pages dealt with lending for construction, debenture charge, shares, eurocurrency, and real property.

(ii) There was extensive scope within the guidelines for the exercise of discretion and the making of unspecified exceptions. This was most evident in the guidelines for lending for construction, and lending to be secured by shares.

(iii) The guidelines were reviewed from time to time, but a distinction should be drawn between guidelines dealing with the procedural matter of delegated lending authorities, and those dealing with the substantive aspects of structuring loans. The delegations were reviewed fairly frequently as to the persons authorized and the prescribed limits. The substantive guidelines were reviewed less frequently - the board reviews of any substance took place in November 1984, March 1987, and February 1988. It is not clear whether the lending guidelines (as distinct from other guidelines) were reviewed in June 1986.

(iv) Mr Moyle raised the potentially volatile state of the share market as a guideline issue in February 1987. That led to the more extensive, but hardly restrictive, guidelines on lending for shares in March 1987. Mr Rawlins raised queries in December 1987, following the stock market collapse in October 1987, about the lending delegation system, the
acceptance of mining leases as security, and the maintenance of security values on loans secured by scrip. That led to a limitation in January 1988 being placed upon the total exposure to mining leases as security (that limitation was not picked up in the subsequent guidelines). The amendments made to the guidelines in February 1988 were those proposed by management. Mr Moyle raised the issue of capital adequacy at that time, in the context of the guidelines, but the board decided for the time being not to include any limit on the size of loans to individual borrowers in the guidelines. And then there were the issues of credit policy raised so urgently by Mr Ryan and Mr Moyle in April 1989, just before the collapse of Tricontinental.

(v) In the main, however, the substantive lending guidelines were not the subject of close and frequent review by the board.

(vi) There was no upper monetary limit expressed for credit facilities to any one client, or client group. The maximum risk value (MRV) formula soon fell into insignificance after its introduction in November 1984, and it was deleted in January 1988. The arrangement for lending up to 20% of SBV's capital base to any one client group found no expression in the guidelines, although the possibility of some such inclusion was considered at the board meeting in February 1988.

(vii) Lending for construction was permitted up to the lesser of 70% of 'on-completion' valuation or 80% of total construction costs. By definition the construction costs included land costs, capitalised interest during construction, and all professional fees. Lending for real property was permitted up to 65% of independent valuation for mortgage purposes before January 1988, and 65% to 85% after then. In fact, in some cases, 100% of the cost of commercial real estate development projects was advanced, particularly to those which were structured on a tax-effective basis. Evidence established that the use of tax-effective arrangements for funding commercial property development was widely practised in the finance industry during the property boom. The funding of 100% of developments was not reflected in the guidelines,
other than by the provision for exceptions approved by the board, added to the construction guidelines in January 1988.

(viii) Lending secured by debenture charge was permitted by guidelines with fairly minimal covenant criteria. This deficiency was pointed up by the more extensive covenants proposed by Mr Mountford in May 1989.

(ix) Lending against the security of shares was permitted with minimal guidelines before March 1987, and with scope for wide discretion after then. The guidelines were so sketchy as to provide little guidance at all. For example, there was no requirement for the assessment of the shares put forward, and the companies in which they were held, in matters such as net tangible asset backing, liquidity, volatility, profitability and dividends. Nor was there provision for different bands of margins or multiples for various groups of shares. This is another area in which deficiencies were pointed up by the changes proposed by Mr Mountford in May 1989.

(x) The requirement for a minimum times cover was without meaning in the absence of any prescription of the shares which might be accepted as security. It was even possible for major credit ‘trading lines’ to be approved by directors, with approval of the shares to be purchased or otherwise offered as security left to the discretion of the managing director.

(xi) The basic point is that a cover of 1.3, 1.5 or 1.8 times meant nothing if the shares could prove to be worthless, and if more of the same were relied upon for top-up.

(xii) A very important aspect of the inadequacy of the criteria for lending for shares was the lack of any prohibition upon accepting as security shares in a related company upon which the borrower relied for cash flow. If the borrower or the related company got into difficulties, then it was almost certain that shares held as security would lose much, if not all, of their value. In reality, the security was no better than the borrower.
A further aspect of lending for shares was that although the guidelines (from March 1987) required that shares held as security should not exceed 5% of the share capital of the company to which they related, the guidelines permitted exceptions of an unspecified nature. The Commission found no instance in which this guideline was considered as a possible inhibition, let alone applied. As the Commission’s examination of Tricontinental’s transactions has revealed, there were a number of examples of high percentages of issued shares being held, when those shares were unmarketable and proved to be of little or no value.

As discussed in chapter 11 of this report, there was a lack of objective criteria for the assessment of credit risk.

The adequacy of the substantive lending guidelines approved by the board cannot be assessed in isolation from other circumstances. The primary requirement was for Tricontinental’s lending business to be conducted prudently, in accordance with the principles of proper credit risk management. Arguably, the need for detailed and well documented lending criteria could vary according to the levels of skill and experience of management and staff, whether internal control procedures and practices ensured that credit risk was properly evaluated and managed, and whether the quality of the loan portfolio was carefully monitored.

The Commission considers that on any view the lending guidelines were inadequate. That inadequacy was further emphasised by the shortcomings in Tricontinental’s analytical, approval and monitoring processes, as demonstrated so vividly by the transaction reports.

The inadequacy of the lending guidelines was a factor that contributed to Tricontinental’s losses, and for that the board is responsible.

That is not to say that the losses would necessarily have been prevented or reduced if there had been more adequate guidelines. In addition, there would have been the need for a wholly different approach to their significance and application, as discussed in the next sub-section of this chapter.
The real point, however, is not so much that the lending guidelines were inadequate (which they certainly were), but that they were indicative of the "flexible" high risk for high reward strategy which was deliberately adopted by the Tricontinental board.

(ii) Observance of the lending guidelines by management and staff

In the first report, at para 22.26, the Commission noted that there was uncertainty in the evidence, which needed to be resolved, as to the extent to which the guidelines were complied with in practice. Various estimates were given by witnesses as to the extent of departures. Carr thought they were rare; Moyle conceded substantial departures, but said that they were justified at board level; Stott estimated that 10% to 20% of credit submissions which he saw exceeded the guidelines.

As a result of examining specific transactions since the first report, the Commission now has a clearer picture. It is not necessary to be precise. The Commission finds that the departures from the guidelines were extensive, both in number and substance. This is hardly surprising, given the policy proposed by Johns, and endorsed by the board, to be flexible and responsive to the requirements of clients.

The first question is whether the directors required or expected strict observance of the lending guidelines by management and staff.

As already noted in para 15.128 above, the three year plan adopted by the board in May 1986 stated that "no rigid [lending] guidelines are in force and this allows managers to be innovative and commercial in their approach to financing".

The minutes for the same board meeting record that Johns "assured the board that all submissions tabled were within the various internal guidelines and policies".
15.288 Counsel for Tricontinental submit that the assurance by Johns was a sufficient basis for directors to assume that this position continued, without their having to seek repeated assurances. The Commission concludes, however, that the minutes are equivocal as to whether Johns was speaking generally, or only about the submissions tabled at that meeting. Further, it is not clear whether the assurance was intended to apply to all submissions listed at the meeting, or only those approved under discretion by persons other than the directors.

15.289 The addendum to the three year plan, considered by the board in May 1987, stated that the lending division maintained a "high measure of flexibility within established guidelines which are regularly revised in the light of loan demand and economic outlook".

15.290 Tricontinental's submission to the Reserve Bank, dated 18 January 1989, claimed that Tricontinental had "effective operational guidelines which are in day-to-day use".

15.291 It is perfectly clear that it was within the province of directors to approve credit submissions which departed from the terms of the guidelines which they had laid down. The position is less clear in the case of persons exercising delegated authorities to approve submissions, below the level of four directors. Evidence before the Commission shows that conflicting views existed.

15.292 At least some directors, and possibly all of them, believed that delegates below the four director level were bound to observe the guidelines strictly when exercising their discretions, in the absence of board approval. On the other hand, Johns and other managers believed that, within delegated monetary limits, they were free to depart from the guidelines, just as the directors were for the larger amounts.

15.293 Ryan described the lending guidelines as "sacrosanct" for credit submissions below the level of those requiring approval by directors. Any departure from the guidelines required approval by directors. In his view, the managing
director was bound by the guidelines when exercising his discretion below $6m. On the other hand, the directors were entitled to depart from the guidelines.

15.294 No doubt the logic behind the perceived distinction was that it was the directors, not the executives, who determined the application of the guidelines.

15.295 Smith and Moyle expressed views similar to those or Ryan. Moyle said that guidelines, once adopted by the board, were assumed to be complied with unless the board was informed otherwise. Departures should have been specifically disclosed, and the justification of departure presented to the board.

15.296 Morton took a more pragmatic view. He agreed with a suggestion put to him by counsel assisting that, in order to find Tricontinental's lending policy, it was necessary to look at what happened to individual loans. The inference was that the policy was not to be found in the guidelines.

15.297 Johns was largely responsible for shaping the attitude taken towards the lending guidelines by management and staff in the lending, credit and security areas. As to the exercise of his own delegated authority to approve facilities under $6m, Johns took the view that he could go outside the guidelines at his discretion. He said that he was never told the contrary. As a result, credit analysts did not see it as their function to query a departure from guidelines when a matter was put forward by Johns which would fall within his discretion. This approach was stated by Mr Alistair Clark and Mr John Adgemis. The latter said that, in relation to Johns' transactions, "We did what we were told".

15.298 Counsel for Tricontinental submit that, when delegated authority was exercised, directors were entitled to assume that the guidelines would be complied with, unless the board was otherwise informed. It was not incumbent on the directors to seek positive assurances in relation to each
exercise of discretion. Thus, unilateral decisions by Johns about the first Atoll facility constituted breaches of the share cover guideline - first, when he approved the facility on the basis of share cover of 1.25 times, contrary to the board's guideline requiring a minimum cover of 1.5 times for mining shares, and later when he approved an extension of the facility for twelve months with a share cover requirement further reduced to 1.1 times. Counsel submit that these were unauthorised departures from the guidelines and other directors ought to have been consulted. However the board did later approve the extension with a 1.1 times cover.

15.299 As to matters to be approved by the directors themselves, Johns encouraged his managers not to be constrained by the guidelines. Johns said that he used to tell his marketing staff that if they were going to say 'no' to a borrower, they had to give a reason and justify the answer, to assist the client to go somewhere else or perhaps to package the loan in a different way. He said that the lending division and the group overall were proud of the enormous growth in the loan book during the year ended 30 June 1986.

15.300 Johns believed that guidelines were there for the lending people, but there were always exceptions to the rules. Whether or not a particular proposal was to be an exception to the guidelines was up to the individual manager at the time, and that manager's assessment. Johns said that he stressed to managers that they should always think with an open mind when assessing proposals. Each proposal was to be looked at independently and separately.

15.301 This attitude was put in unmistakable terms in a memorandum dated 26 September 1988 by Johns to Mr David Hadley, manager of the Sydney office. The memorandum related to Essington Limited, and stated:

"I received a phone call from Malcolm Edwards last Friday evening advising of your meeting on Friday and comments that TCL could not provide further funds to Essington due to "Prudential Limits". David, firstly, this is not correct, and personally, you have no right to make this statement.

One of the major reasons for TCL's success and continued success is
15.302 It is not surprising then, to find that managers and staff who gave evidence showed a relaxed attitude to the guidelines.

15.303 Mountford recalled that Johns’ directions to him and his staff were for them not to consider that they had a self-imposed ceiling in their negotiation with clients. He said that the lending guidelines "did not represent rigid policy, but were intended to convey general guidelines to new and junior lending staff".

15.304 Stott said that it was the responsibility of each divisional head to ensure that staff in their respective divisions were made aware of the guidelines applicable to their division and to monitor adherence. However, Stott added:

"Tricontinental's management regarded the guidelines as general indicators rather than rules. They were not seen as rigid or exhaustive but as a framework within which Tricontinental's lending operations could operate. Each submission was, in any event, considered on its own merits depending on its own factual matrix. It was up to lending officers and those involved in the approval process to determine the extent (if any) to which lending guidelines were exceeded."

15.305 Mr James Wigginton joined Tricontinental in May 1988 as assistant general manager lending. He said that, on arrival, he was provided with a set of guidelines as to lending. He understood that the guidelines were just that - there was no obligation on lending officers to observe them rigidly, because in most cases the board made the decision, and they knew the percentages (the loan to security ratios) prescribed.

15.306 Mr John Maddison joined Tricontinental in July 1985, and progressed through appointments as lending officer, credit analyst, assistant group manager credit, and eventually group manager credit after the resignation of Mr Clark in early 1989. He said that guidelines would be consulted by credit analysts as and
when necessary, and sometimes were departed from if it seemed justifiable in relation to a particular proposal. He also said:

"The credit analyst did not at any stage so far as I can recall highlight in the submission the fact that such a departure from the guidelines has occurred but the relevant figures and ratios were set out in the credit submission so that a departure from the guidelines should have been readily apparent. I believe that the directors and executives at Tricontinental knew what the guidelines were and were therefore able to pick up for themselves instances of departure from the guidelines."

He said that the guidelines did no more than provide an indication of the kind of lending transaction that Tricontinental was prepared to undertake. They provided general parameters.

15.307 Mr Alistair Clark joined Tricontinental as a senior analyst in late 1982, was promoted to assistant manager credit in mid 1984, but resigned in late 1984. He rejoined Tricontinental in July 1985, and was promoted to group manager credit in November 1986. He again resigned in January 1989. He said that junior analysts were given copies of the memoranda containing the guidelines. If Johns proposed a transaction outside the guidelines, Clark did not see it as the credit department’s function to query it. When credit submissions went to the board, it was never stated that guidelines were adhered to or departed from, but the ratios were always put on the credit submission face sheets.

15.308 The more junior credit analysts regarded compliance with the guidelines as beyond their purview. According to Miss Claire Coutts, analysts were not required to be familiar with the guidelines. Analysts inserted the share cover ratio in a particular submission in accordance with the figures they were given. She did not regard it as her position to say that a particular proposal was outside the guidelines. Mr Adgemis did not even recall the share cover guidelines. He did not regard it as his function to check on departures from guidelines.

15.309 The Commission makes the following findings as to observance of the lending guidelines by management and staff:
Directors expected all persons exercising delegated authority below the level of directors to comply strictly with lending guidelines.

The expectation extended to approvals by the managing director.

Directors expected all submissions put to them for approval to comply with the guidelines, alternatively, that proposed departures would be brought to their notice and reasons advanced in support of them.

It follows that they also expected all staff involved in the preparation and presentation of credit submissions to be aware of the guidelines, and to identify proposed departures.

The guidelines did not specify these expectations as requirements to be observed.

On the other hand, Mr Johns believed that he, and other holders of delegated authority, could depart from the guidelines, as they saw fit, in the exercise of their powers.

Mr Johns actively encouraged managers to solicit lending business and to present credit submissions without feeling constrained by guidelines. This approach inevitably filtered through to other staff.

Credit analysts would not query any departure from guidelines by Johns. Nor, in the main, did they regard it as their function to query departures from guidelines in credit submissions to be presented to the board for approval. Evidence indicates some variation amongst individual lending officers and credit analysts in this respect, but the general thrust of the evidence is quite clear.

The difference in understanding between directors and management was quite fundamental. It was partly the result of a failure by the board to make its intentions clear in the guidelines themselves. It was also partly the result of the attitude of Mr Johns, who was primarily concerned with Tricontinental's "ability to handle volume".

The Commission is unable to determine, particularly in the absence of evidence from Mr Johns on the point, whether he had a genuine misunderstanding of the directors' intentions as to the observance of the guidelines, or whether there was a deliberate disregard of them on his part.
In the end not a great deal, in terms of the eventual losses by Tricontinental, turns upon the exercise of delegated powers outside the terms of the lending guidelines, because more than 90% by value of the credit facilities were approved by the directors themselves.

The question in that case is whether the directors were aware that credit submissions approved by them departed from the lending guidelines, when there were departures in fact.

Observance of the lending guidelines by directors

There was no system which required certification that a credit submission put to the directors for approval complied with lending guidelines or any other particular requirements. Instead, there were so-called "recommendations" for approval, made by lending officers, credit analysts and credit committee members. When a credit proposal emanated directly or indirectly from Johns (and that was the case in a high proportion of the total, by dollar value), this recommendation process was devoid of real substance.

It is submitted by their counsel that the directors had a working knowledge of the lending guidelines. The Commission accepts this, first, because the lending guidelines were put before the directors from time to time, whenever amendments were considered. Secondly, it is inconceivable that directors would be actively involved in the process of approving major credit submissions without being aware of the main provisions of the guidelines.

Clark expressed the opinion that, if the directors had been sufficiently aware of the details of the lending guidelines, they would have apprehended, upon reading a credit submission, that the guidelines had been departed from. Management apparently believed that the directors were sufficiently familiar with the guidelines to recognize a departure without it having to be pointed out. That may well have been so, but it begs the question of whether the submission contained sufficient material to enable the directors clearly to recognize a departure.
A particular point needs to be made about the approval of credit submissions for project development financing. The project financing division was formed in 1985 under Mr Warren Atlas, but it did not blossom until about 1987. According to Atlas, 100% financing for development projects structured on a tax-effective basis was standard throughout the financing industry, and at some stage this was accepted within Tricontinental, whatever the guidelines said. This requirement did not fit into the existing guidelines for either construction or the purchase of real property. The view could be taken that there were no relevant guidelines, or that lending 100% was a departure from the limit of 80% of construction costs in the construction guidelines.

It is possible that the proposal by Mountford, in January 1988, to amend the guidelines for lending for construction by permitting "exceptions approved by the board" was designed to accommodate project financing of the type described by Atlas. Once that amendment was adopted by the board (almost certainly in February 1988) it would no longer be correct to say that 100% financing of a construction project was a departure from the guidelines, provided that it was consciously approved by the board. Rather, the submission would be approved pursuant to the exception, in accordance with the guidelines.

Atlas stated that it would be obvious from a project finance credit submission that the proposal was for 100% financing.

The board's awareness of the position is underlined by the minutes of the board meeting on 26 April 1989, when Moyle suggested that the reassessment of credit policy sought by Ryan should include "look[ing] more closely at property development and not to finance 100% nor capitalise interest, to finance 75% of valuation unless separately insured".

Moyle listed in evidence the types of departures from guidelines of which he had become aware as a result of the Commission's inquiry, but which he had
not been aware of at the time of submission approval. These included renewals or extensions of loans which exceeded the maximum loan against security value; failure to obtain up-to-date valuations, or proceeding when minimum valuation requirements had not been met; and accepting shares as security beyond the permitted maximum percentage of total shareholding.

Carr recalled that there were some occasions when Johns pointed out to the board that the guidelines had been exceeded, and he was able to give an acceptable explanation as to why that situation had occurred and why the loan submission should be approved. It is not clear, however, whether this evidence was intended to refer to discussion before approval, or at the later stage of ‘formal confirmation’ at a board meeting. It seems more likely to have been the latter. In the view of the Commission this would have been a very rare occurrence, given the complete absence of details before the board at those times.

It is beyond doubt that there were numerous and substantial departures from guidelines in credit transactions approved by directors. These are discussed in chapter 11 of this report in the context of evaluation of credit risk, and later in this chapter when the approval of credit submissions by directors is discussed.

It is self-evident that the quality of the credit submissions would have been improved significantly if the submissions had pointed out proposed departures from the guidelines, and justified in some detail the reasons for doing so. This would certainly have been of assistance to directors in considering the credit submissions; but such assistance was never sought by directors.

Counsel for Tricontinental submit to the Commission that it was an entirely reasonable expectation of directors that proposed departures from the guidelines would be pointed out to them. Given the volume and detail of loan approvals required of them, directors should not have been expected to work out for themselves the relevant ratios and percentages in order to ascertain
whether or not a guideline had been departed from. Such calculations should have been part of the routine work of putting together the credit submission, because consideration should have been given in any case to the justification for departing from the policy laid down by the board. It would follow that both the calculations and the supporting justification for the departure could and should have appeared in the credit submission.

15.322 All this may be perfectly correct, but the evidence shows that lending officers and credit analysts responsible for the contents of credit submissions, and their managers, simply did not ensure that proposed departures from the guidelines were spelt out, let alone that justification for such a departure was provided.

15.323 If a credit submission failed to draw attention to a proposed departure from guidelines, were the directors entitled to assume that there was no departure involved? This question is of some importance, because the answer could colour the attitude directors were entitled to take when considering a submission. If they were entitled to assume that it complied with the guidelines, then their approach to approval could be more relaxed than if they knew that the submission might have departed from the guidelines.

15.324 A further complication must be added. Not all credit transactions were the subject of formal credit submissions at the time of approval by directors. Examples include loans to Atoll, Qintex Australia Limited, Tibham and Markland House. Some of the most noteworthy departures from guidelines occurred in such circumstances. Questions arise as to what directors were told. The clear impression left by the evidence is that in such cases it was common for a minimum of information to have been given.

15.325 The Commission makes the following findings as to the observance of the lending guidelines by directors:

(i) The directors were at liberty to depart from their own guidelines.

(ii) The directors had a sufficient working knowledge of those guidelines.
(iii) There was no express requirement in the guidelines that the directors should be informed of any proposed departure from guidelines in a credit submission put to them for approval, nor that reasons were required justifying the proposed departure.

(iv) Senior management, lending officers and credit analysts did not attempt to ensure that the directors were specifically informed of proposed departures. Mr Johns was primarily responsible for this.

(v) When credit transactions did involve departures from the guidelines, in some cases the departures were discernible from the material in the credit submissions (ranging from the obvious to the obscure), and in some cases the departures could not be detected.

(vi) However, directors must have found many such unannounced departures in the submissions put to them for approval, and they were on notice that proposals might involve departures, even though not specifically brought to their attention. This was so despite the assurance given by Mr Johns to the board in May 1986 (see para 15.287 above). Even if that assurance had general application at the time (which is not clear), it was certainly overtaken by later events. Directors took no action to remedy this situation.

(vii) Compliance with the guidelines was no guarantee of commercial prudence. This was because of the hollow nature of the guidelines. Nevertheless, there was likely to be even less guarantee in the event of departure from the guidelines.

(viii) The failure of directors to be fully informed cannot all be blamed on Mr Johns. Essentially, there was no system to ensure that they would be fully informed. Responsibility for that lay at least partly with the directors themselves.

(ix) In the end, however, the most important issue is not whether directors complied with or departed from their own lending guidelines. It is whether they made their lending decisions upon proper information, and whether they tested that information against appropriate prudential criteria, and had proper grounds for satisfaction, before granting their
approval for any particular transaction. This issue is examined in the next section of this report.

E. Approval of Credit Submissions
(a) Introduction

15.326 The activities of Tricontinental’s non-executive directors did not begin and end at the board table. One of their most important duties, which required them to examine, consider and approve major credit submissions, was of an executive nature. This function took the directors to the very heart of Tricontinental’s major day-to-day business activities. Moyle stated that “there should really have been only matters of principle to be settled at the stage directors received applications”. In practice the requirement was quite different, and the directors undertook a heavy burden. Approval could not be a mere formality, or involve only policy considerations, nor was it treated in that manner. For example, Carr gave evidence of the detailed analysis which he, as a director, would need to undertake to assess the risk factors, before approving a credit submission.

15.327 In chapter 11 of this report, consideration is given to the policies, procedures and practices underlying the preparation of credit submissions, and the shortcomings that occurred in particular submissions. In addition, the procedure by which directors considered those submissions is also examined.

15.328 In volume 3 of this report, the transaction reports set out details of the particular credit transactions examined by the Commission, including aspects of the relevant credit submissions.

15.329 In this chapter attention is drawn to the inadequacy of the system used by directors to consider credit submissions, to the more common defects in the submissions that were approved, and to what those matters reveal about the quality of decisions made by the directors.
15.330 (b) 'Round robin' system

It has already been noted that the skills and experience of the Tricontinental directors appeared adequate for a merchant bank board, provided that their skills and experience were applied both diligently and collectively (para 15.15(vi)).

15.331 Unfortunately, the approval of credit submissions for more than $6.5m, by directors using the 'round robin' system, was not a collective exercise of skills and experience. It meant that non-executive directors were called upon to perform a vital executive task for which apart from Moyle and Ryan, they were not individually well qualified.

15.332 The directors went about their task in an essentially non-executive manner, and for the most part deprived themselves of the mutual support that was necessary to compensate for their individual limitations.

15.333 The shortcomings of the round robin system are examined in detail at paras 11.60-67. The monthly reports by the managing director to the board show that over 90% (by value) of the credit facilities granted by Tricontinental in the crucial 1986-1989 period were approved by directors under this system.

15.334 There was a wide variation in the extent to which individual directors participated in the process of approving credit submissions. This is shown (by value) in the table in para 11.77. It shows that Johns participated in virtually all approvals, and Ziebell in practically none. Smith's participation varied from year to year, but was heavier in 1988 and 1989. Ryan participated heavily throughout. Moyle also participated substantially, even though Carr, as his alternate, covered for him before April 1988, whenever he was not available to deal with submissions quickly enough. Rawlins' participation was modest, up to his resignation in April 1988. Morton was slow to become involved, and never did achieve a high proportion. Carr participated heavily when he became a director (and Moyle then participated less).
Ryan participated heavily because he was usually "available on the day", and was able to turn credit submissions around quickly. He would sometimes telephone Johns about a particular submission, and he would quite often go into Tricontinental’s office and talk with the relevant loan officer or analyst about the submission. This was unique among the non-executive directors. There is little to suggest, however, that consultation often followed between Ryan and the other non-executive directors, despite some evidence that others were interested in finding out from management what Ryan had decided.

Carr approved 306 submissions between July 1986 and late April 1988, as alternate to Moyle. Between late April 1988 and May 1989 he approved 339 submissions in his own right, following Rawlins’ resignation. (These were submissions for all types of transactions, not only lending.)

Curiously, when giving evidence Carr initially could not recall having approved any submissions in place of Moyle, although he did so later when records were brought to his attention. As alternate to Moyle, he rejected only one submission. He did not know whether the Tricontinental board was informed that he was approving loans on behalf of Moyle in that period. Carr does not recall Moyle drawing his attention to any Tricontinental guidelines to help him in exercising his judgment before April 1988.

Morton did not consider that it was a fair view of his limited involvement for Stott to say, as he did, that "Mr Morton was rarely used as he was a reluctant participant and had other business commitments". In the early period he had other pressing commitments, but he said that he really wished to learn something more of Tricontinental’s business before becoming heavily involved in loan approvals.

Ziebell said that he undertook no role in either the approval of loans as a director, or in the later confirmation of loans by the Tricontinental board. (In fact, he did approve a few submissions - see the table in para 11.77.) Ziebell
said that he didn't consider that he had the experience to venture an opinion; he had his own areas of expertise and considered it appropriate to concentrate on those, rather than to venture opinions in an area where he had no expertise. There was also a very blunt statement to him by Johns that he should keep out of the lending area.

15.340

The involvement of individual non-executive directors in approvals has been sampled another way. Commission staff have drawn up a table from the transactions examined by the Commission in public hearings. It includes approvals for new or increased loan facilities, but excludes approvals of extensions of time. The directors are ranked according to the number of facilities approved:

<table>
<thead>
<tr>
<th>Non-Executive director</th>
<th>Number of facilities approved</th>
<th>Value $m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ryan</td>
<td>34 (85%)</td>
<td>744 (83%)</td>
</tr>
<tr>
<td>Carr</td>
<td>23 (57%)</td>
<td>513 (58%)</td>
</tr>
<tr>
<td>Smith</td>
<td>20 (50%)</td>
<td>602 (68%)</td>
</tr>
<tr>
<td>Moyle</td>
<td>17 (42%)</td>
<td>422 (47%)</td>
</tr>
<tr>
<td>Morton</td>
<td>10 (25%)</td>
<td>191 (21%)</td>
</tr>
<tr>
<td>Rawlins</td>
<td>5  (12%)</td>
<td>139 (16%)</td>
</tr>
</tbody>
</table>

The distribution of approvals by individual directors among the particular transactions examined by the Commission is summarized in attachment 15A.

15.341

Johns said that the round robin system was in existence when he joined Tricontinental. He did not recall that it had ever been discussed by the directors. There is no doubt, however, that Johns used the system as a means of pushing Tricontinental's reputation for quick decisions. The system imposed a heavy and responsible executive load, in a demanding time-frame, upon persons who were already busily engaged in other pursuits. The only non-executive director with ample time was Ryan, who had retired at the end of 1985.
15.342 The mechanism by which major credit submissions were brought to and dealt with by directors is examined in detail in chapter 11. The directors said that in general they were satisfied with the system. Moyle said that he would have preferred regular weekly meetings if time had permitted. The Commission is not persuaded that time could not have been found.

15.343 The Commission has not overlooked the fact that a highly regarded corporate banker - Mr Moyle - approved a substantial proportion of the credit submissions. His approvals could be used to support an argument that the less experienced directors arrived at the correct answers anyway. The Commission concludes however that all of them, including Moyle, independently arrived at the wrong answers in many of the cases examined. The point of collective consideration is that it should have led to deeper and more informed discussion and better decision-making by the directors.

15.344 There was some confusion in evidence as to whether or not all credit submissions were distributed to all directors for approval. This is discussed in paras 11.68-76. Johns, Moyle and Mountford understood that the submissions went to all directors, but the evidence of Stott, Clark, and Maddison was that, unless Johns directed that a particular matter was to go to all directors, the distribution was selective, depending upon who was most likely to be available. The Commission prefers the evidence of Stott, Clark and Maddison on this point, as they were involved in the actual distribution process, and there is no reason to doubt what they say. Approvals were obtained from Johns and three other directors in most cases, but in the cases reviewed by the Commission there were some where only three, or even two, directors gave approval.

15.345 The result was that not all directors saw all credit submissions as part of the approval process. This fact gives added significance to the role of the 'formal confirmation' process at board meetings. There was conflicting evidence about what documents the directors saw there, what documents were available if
required, and what took place in discussion. These matters are examined in some detail at paras 11.86-102.

15.346 It may be that, if for some reason an application arose for approval at the meeting itself, there was then more detailed discussion. This could have happened on rare occasions when a request for urgent approval coincided with the occurrence of a regular monthly meeting. The Commission is satisfied, however, that for the most part the 'formal confirmation' of submissions already approved before a board meeting was no more than a noting exercise. By then most, if not all, decisions had already been implemented by letter of offer and, in many cases, drawdown. The Commission is satisfied that, after July 1985, the so-called "agenda reference" pages of credit submissions already approved by directors were not distributed to the directors with the papers for the board meeting, either before or at the meeting. A set of those pages was available to Johns at the meeting, for reference by him should any questions be asked. Johns estimated that, on average, Smith took about 5 to 15 minutes to go through the schedule of credit submissions already approved. (This would include those approved under the managing director's discretion.) The time taken would depend upon the number of questions asked. Johns did not recall that any alterations were ever made as a result of any questions asked. In any event, approvals were not conditional upon later confirmation. Accordingly the procedure added little, by way of review and control, to approvals given individually by directors in the round robin process, or to Tricontinental's credit evaluation process generally.

15.347 Returning to a description of the round robin system, there is evidence that, if a query arose in the mind of a director he would, if necessary, discuss the matter with another director or with one or other of Johns, Mountford, Stott or Maddison. Morton was an exception. As a matter of principle, he would not discuss an application with anyone responsible for its preparation or promotion (including Johns). Instead, he would speak to an "independent" director, most often Carr.
Smith made it clear that he did not profess to have expert merchant banking knowledge or experience. He examined credit submissions himself, but drew comfort from the belief that the examination of submissions by the other directors available on each occasion resulted in "proper scrutiny by expert and experienced bankers". Further, he believed that he was entitled to rely upon management to perform satisfactorily.

It appears that discussions between directors did occur from time to time as part of the round robin system, but not very often. Directors accepted the desire by Johns to achieve a quick turnaround of submissions, and sought to meet that objective. Moyle said that sometimes there was a need for urgency, but more often there was just a desire to enhance Tricontinental's reputation for quick decisions. Ziebell said that Johns prided himself on the quick turnaround of submissions. This, of course, was part of the marketing strategy. It is clear that the desire for speed had an important bearing upon not only the preparation and presentation of submissions by staff and management, but also their consideration by the directors.

(c) Reliance on management

The round robin system involved heavy reliance upon management, and in particular upon Johns. Directors stated their belief that the analysts and management generally carried out their jobs satisfactorily. Rawlins said that the amount of financial detail in credit submissions varied according to the complexity of the loan, and whether it was a new client or an extension or variation of an existing facility. His satisfaction with the general standard of credit submissions contrasted with his dissatisfaction about the standard of information provided to the board about problem loans.

Directors took comfort from their understanding of the system of multiple review of a credit submission before it came to them for approval (paras 11.114-118). As discussed in chapter 11, this was a mistaken trust in the system. First, there needed to be in place proper guidelines for the assessment
of credit risk, together with staff who had the skills and experience required to produce a balanced credit appraisal, and then the opportunity for the staff to do their work properly, without pressure to produce mere selling documents designed to ensure board approval. In fact, a high proportion of the lending transactions emanated directly or indirectly from Johns, and management and staff felt the need to ensure that he was given what he wanted (see paras 11.122-131; 11.313-314).

15.352 As noted in chapter 13, Johns maintained very close relations with most of Tricontinental's more substantial clients, and tended not to record or pass on full information to other managers. Managers and staff tended to assume that Johns had the necessary information. For his part, the objective was to support entrepreneurial starters and grow with them. If the business was likely to be profitable enough, he would ensure that a way could be found to do the business.

15.353 As also noted in chapter 13, Johns was able to influence the decisions of the board by the selective nature of the material supplied in the credit submissions. Information that might arouse concern was quite often omitted, and no attempt was made to highlight any risks that might have been apparent only from a careful study of the material provided. Johns said he did not expect credit submissions to identify the 'down-side' in proposals. Johns believed it was really up to the individual members of the credit committee or the board to identify any 'down-side', and consider it in relation to the 'lending factor', ie the percentage they were going to lend against the asset. Furthermore, if an unfavourable response was received from any director, Johns immediately communicated with that director, and was usually successful in achieving a change of mind or, almost without exception, gaining the support of most of the directors, so as to carry the day in any event.

15.354 A further point is that some important credit applications did not go through the system in the normal way. Urgency was said to justify the lack of any
formal submission, or sometimes of even a short memorandum. Directors were contacted, usually by telephone, by Johns or another senior officer and given an outline of the proposal. A formal credit submission was put through the system after approval had already been given. Johns said that when this procedure was followed, a copy of the credit submission which was later drawn up would be sent to directors for their information. On the evidence it is clear that this was not done, and there were some cases in which significant information appeared in the later credit submission which directors claimed never to have been told.

15.355 Another matter examined in paras 11.103-106 is the variation by management (principally Johns) of the terms and conditions of credit facilities after approval by the directors. Significant examples are listed at para 11.103. Management considered that the managing director had some substantial but undefined discretion, but there was no evidence to justify that view. Directors gave evidence that such variations were unauthorised. If there had been a need for significant variation, there should have been a further submission, or at least a report to the board.

15.356 As to the quality of the credit submissions, Moyle said that, although they were not of the same high standard as SBV credit submissions, they were generally of "good, acceptable" quality. SBV credit submissions were more complete and the analysis was more penetrating than Tricontinental's submissions. He said that the sort of information that management had available to it seemed to provide a comprehensive source of information to enable credit risk assessment, and he saw no reason to believe that the information contained in the credit submissions was anything but accurate. There was never a concern that such information might have been affected by time pressures. Moyle said he expected credit submissions to be accurate on their face. He did not expect that he would have to check the relevant information contained in the submissions. In most cases he was satisfied with
the information provided. He never had reason to believe that information contained in credit submissions was misleading. Moyle's views were representative of the views of other directors, except that, from about mid-1988, Ryan became more questioning and less ready to approve submissions upon the information initially provided. In some cases, towards the end, Carr also expressed reservations and required further information before granting approval.

15.358 Carr said he placed considerable reliance on the process undertaken by management and the managing director before the credit submission reached the directors. He said that he never had cause to question the competence of the senior lending executives, the credit department or Johns. As a director, he relied upon the information in the credit submissions to make his decision. When he did seek additional information, Johns was his initial point of contact. He sometimes spoke to Mountford if Johns was unavailable. He thought that, if he had learned something that was particularly significant that other directors should know, he would have told them, but he could not recall any particular occasion. He did not see the fact that Johns was the primary source of answers as being a potential weakness in the system.

15.359 The satisfaction which directors said they generally felt about the quality of information contained in credit submissions, and their faith in the management processes which produced and presented the information to them, stands in sharp contrast to the substantial deficiencies that in fact existed in the submissions.

15.360 (d) The quality of credit submissions

Hindsight now enables the Commission to identify defects that would not have been apparent on the face of the submissions at the time of approval. Defects of that nature could have had the effect of misleading the directors who read the submissions. Para 13.126 refers to some examples.
On the other hand, credit submissions were frequently deficient in ways that could be seen in the submissions themselves. That was the case when information that directors should reasonably have expected to be there, was either absent or clearly inadequate.

The absence of information from submissions is considered in detail in paras 11.135-161. Reference is made to the following omissions:

- The absence of critical evaluation. Only 'up-side' factors were shown, not 'down-side'. This was in contrast to SBV's credit submissions after integration, which routinely included a section on "prime risks and mitigants (sic)". This deficiency in analysis illustrated the dominance of lending considerations over credit risk evaluation.

- The absence of cash flow analysis and projections. The credit submissions examined in public hearings commonly lacked any useful analysis of the capacity of borrowers to service and repay loans from maintainable cash flows. There was heavy emphasis upon security, which in many cases comprised shares, but without serious evaluation of the likely worth of the shares if borrowers got into difficulties. Often the shares were those of a company related to the borrower, upon which the borrower relied for cash flow. If a share was potentially worthless, then multiples of it, under the 'times cover' security guideline, gave no added comfort.

- The absence of other forms of information relevant to credit risk. These included failure to assess the business risks associated with the proposed use of the borrowed funds (or even disclosure of the proposed use at all). Great faith was placed in the business judgments of the clients.

- Failure to consider material already in Tricontinental's files. This failure included lack of reference to related transactions, or earlier defaults. On the other hand, there was often reference to out-of-date financial material.
To the above list may be added the failure to identify or justify departures from guidelines.

Information that did appear in the submissions could also be cause for concern. Paras 11.162-183 discuss the following matters:

- Reliance on security. The fact that the loan was secured was regarded as the most important factor in evaluating a proposal, but often there was no analysis of the real worth of the security.

- Reliance on spiralling asset values. 'Entrepreneurial' developments relied upon the continuing inflation of real estate values.

- Reliance on a 'take-out' for short-term facilities. The repayment of bridging finance too often depended upon sources that were conditional or not committed.

- Reliance on 'name lending'. There was a desire to be associated with the 'entrepreneurial stars' - in some cases combined with faith in the soundness of complex inter-related corporate groups which defied ready analysis.

- 'Flexibility' in loan structures. The desire to meet the needs of the client often left Tricontinental in a disadvantaged position. This approach led to situations where Tricontinental granted credit facilities to a holding company, which then acted as the treasury for its operating companies, without Tricontinental obtaining access to the cash flow or assets of the operating companies. Tricontinental went to the end of the queue of creditors.

The transaction reports in volume 3 of this report provide ample illustrations of the types of defects listed in the preceding paragraphs. Some of the more conspicuous examples are noted below.
Lack of normal credit submissions:

(i) Atoll - $13.2m facility based on oral information and approval. Stott said that he obtained approval from Smith and Ryan. They do not agree.

(ii) Mainsel - Urgent memorandum sent by Johns and Mountford to Smith, Ryan, Moyle, Carr and Morton for proposed increase and extension of facility in March 1989.

(iii) Tibham - Urgent submission was not in the usual form. The document suggested that the urgency related to use of part of the loan for a share purchase. In fact it was because the due date for payment of a lease premium had passed. The reason for the urgency was important, given Mr Ryan's evidence that his approval was conditional upon a development approval being obtained before drawdown. In the circumstances, that condition could not possibly be met.

(iv) Essington Developments - Urgent memorandum presented to directors.

(v) Qintex Limited - Credit submission prepared, but extremely confusing as to whether directors were being asked to approve a $25m, $50m, or $75m facility.

(vi) Qintex Australia Limited - Approval for first and second facilities both obtained before preparation of credit submissions. Extension on 3 April 1989 without credit submission.

(vii) Markland House - No formal credit submissions to support approval of either facility. On first facility, there was a two page memorandum. No indication of real urgency. Memorandum was most inadequate. For second facility, a credit submission was prepared after approval. There was extreme urgency for that facility.

Departures from guidelines:

(i) Insufficient times cover for shares held as security - Atoll, Smith & Lane, RIFL, Parkston, Kahmea, Dallhold, GSH Investments and GSH Finance.
The Commission also noticed a times cover of 1.18 called for in connexion with a $4.12m facility to Bosane Pty Ltd (a company under the same control as RIFL) for the purchase of (mainly) Kimberley Securities Ltd shares.

(ii) Shares held as security in excess of 5% of issued capital of company -
Atoll (5.7% of Pelsart's ordinary shares, and 10.1% of its options)
Quatro (40% of Pro-image); RIFL (32% of DAC; with other DAC group transactions Tricontinental held a total of 82% of DAC shares as security); Qintex Ltd (25.2% of QAL); Kahmea (52% of QL); Parkston (100% of Entrad, possible takeover exception, but within the group and disposal would have been very difficult); GSH Finance (6.45% of Hooker.)

(iii) Erroneous valuation of shares/assets -
Dallhold (security of $37.23m shares in Mid-East Minerals valued at $150m, i.e. $4.03 each, compared to last sale price of $0.60 shown in Dallhold transaction documents.)
Qintex (25m facility secured by units in limited partnership which had an interest in Princeville Hotel, Hawaii. Value of units based on unconfirmed valuation of hotel.) On the other hand, the board rejected an attempt by Johns to value Qintex shares held as security for Kahmea loans on the basis of alleged value of net tangible assets, rather than post-crash market price.

(iv) Lending on debenture charge in excess of 70% of written down value of assets -
Disctronics (75.2% of total cost of equipment).
Pro-image (one loan approved with a loan to security ratio of 125.3%).
Entrad (proposed security of debenture stock, with loan to security ratio of 91%).

Unsatisfactory structure of loans:

(i) Atoll - Repayment to be from sale of Pelsart shares, which also formed the security. The shares were speculative mining company
stock, and the purchase price was almost 100% of the facility.

(ii) Quatro group - Facilities were provided to several companies in the group, and their securities were interdependent.

(iii) Skase group - Kahmea facilities were secured by shares and notes in QL. The QL facility was secured by shares in QAL. One of the QAL facilities was secured by a guarantee from QL. Another example of interdependent securities.

(iv) Markland House - Little cash flow of its own, dependent upon dividend income from subsidiaries and other investment companies. Tricontinental did not insist on security over the assets of those subsidiaries or investment companies. Instead, security was taken over shares in them. Other lenders with security over assets had first access.

(v) Ramuz - Amounts advanced could not be recovered in full from exercise of mortgage over site. In effect, Tricontinental would have had to become an equity participant in the project, to the extent of the amount advanced and interest capitalised, in the event of default.

(vi) Dallhold - Initially, Tricontinental's security was to be a first registered mortgage over Bond Media shares. As a result of the re-structuring of the loans, Tricontinental's security became second ranking charges and mortgages over Mid-East and Saint Joe shares and the gold mines. By accepting share security for the majority of Dallhold loans up until 1989, Tricontinental was effectively placing itself as a last priority lender in the event of liquidation of the borrower company. Further, a significant portion of the mineral assets were overseas and there would have been difficulties associated with enforcement.

Defects in credit risk analysis contained in credit submissions:

(i) Atoll - No reference to previous default. Insufficient financial information to demonstrate capacity to service and repay the facility.
Realisable value of shares held as security extremely uncertain. Insufficient information about the guarantors.

(ii) Quatro - Insufficient financial information. No reference to defaults in extension submission.

(iii) Pro-image - Lack of reference to related transactions. Purpose not made clear (100% start-up finance for Disctronics). Not made clear that Quatro group relied on capital raisings from public to provide equity and to repay loans.

(iv) Disctronics - Optimistic financial projections accepted.

(v) Mainsel - Inadequate information on value of security, effect of not meeting preconditions, prospects for repayment if development approval not granted or construction finance not obtained, ability to finance any additional costs. Directors not informed of difficulties with title if construction not completed.

(vi) Tibham - Inadequate information as to development approval, nature of security, details of the borrower, details of the joint venture, related exposures, repayment capacity, security valuation, current financial figures. 100% funding proposed, despite significant risks, particularly concerning development approval and construction funding.

(vii) Essington - Inadequate information as to high lending-to-security ratio, related exposures, ability to service and repay facility, existing charges on principal security.

(viii) Rocado (RIFL) - Failure to analyse the effect of the transaction (replacement of existing $15m debt with a letter of credit/guarantee facility for three years), ability to repay, declining share prices for RIFL and DAC.

(ix) Smith & Lane - Incorrect valuation of shares held as security, failure to analyse borrower's financial condition and the effect of the various transactions.

(x) Kahmea - Credit submissions for the three facilities did not contain current financial information. Reliance on cash flows from elsewhere
within the Skase group.

(xi) Qintex Limited - Insufficient financial information to demonstrate capacity to service and repay the facility. Reliance on security, part of which was earmarked to service the facility. Change of purpose of facility. From January 1988, concern about the size of Tricontinental's exposure to the Skase group, and its under-secured position. Later extensions.

(xii) Qintex Australia Limited - Oral information for first facility before approval. Later written submission still showed lack of detailed financial information. Initial short term of facility (10 weeks) created false sense of security. Later extended for three years. Facility effectively unsecured (guarantee from QL, to which nil value was attributed). Tricontinental allowed itself to get into a position where there was little option but to extend the facility until cash flow of the Qintex group improved.

Credit submission for second facility, prepared after approval, still contained insufficient financial information. No information on financial position of US guarantor, or on security of charge over units in a partnership (the assets of which became encumbered elsewhere), or on source of refinancing which was "to be arranged".

(xiii) Markland House - The formal credit submission contained very limited analysis of the financial condition and credit history of Markland House, its subsidiaries and guarantors.

The put option agreement between Markland House and Essington Securities was referred to as an important part of the security, but there was no indication that, if called upon in the first 12 months, Tricontinental would be obliged to finance the put option and thus pay for its own security.

The submission failed to refer to the serious liquidity problem then faced by the borrower and its subsidiaries, even though Markland House disclosed its financial difficulties to Tricontinental.

Tricontinental failed to analyse properly the ability of the borrower to
service and repay the facility from cash flow. Based on the previous year's accounts, the interest on the $16m facility could not be serviced from normal operating cash flow.

There was a failure to indicate the likely realizable value of the charge taken over shares in Yalfa. The credit analysis did not adequately review matters relevant to the current realisable value of the Coogal shares in a declining property market.

(xiv) Dallhold - The credit submission of October 1987 involved little review by Tricontinental's management or directors of the Drexel valuations and advice about the ability to make repayment from the BIG proceeds, or the enforcement of its second-ranked security.

The credit submission of May 1988 contained no current financial statements for Dallhold, although Tricontinental could have demanded audited half-yearly accounts to December 1987. Deficiencies in the Tricontinental method of calculating maximum net exposure were significant. By Tricontinental's method, maximum net exposure to the Bond group was reported to be $178.8m, when in fact the current usage of the Bond group facilities was $281m, almost three times the share capital of Tricontinental.

(xv) Entrad - There was a change of borrower after approval, from Entrad Corporation Limited to Entrad Limited. Financial information in the submission related to the former company. Even that was not up-to-date. Submission recommendation stated that the facility would not increase Tricontinental's exposure, due to restructuring. In fact the overall effect was to increase exposure by $4m.

(xvi) Roxbury Holdings - The credit submission did not contain the most recent financial information; no projected cash flow figures were provided, despite the fact that servicing was to come from cash flow; the assets of Roxbury Holdings were not examined critically.

(xvii) Parkston - The credit submission did not examine the liabilities of Parkston or the Goldberg group to other financial institutions. It did not highlight the risk from interdependency among the group
companies: As the approval of this facility brought Tricontinental’s exposure to the Goldberg group to $167m, careful consideration should have been given to the credit risk.

(xviii) GSH Finance - Cash flow depended principally upon dividend income from Hooker, and income distributed by the Herscu Watts Chimside Unit Trust. Credit submissions failed to disclose that no income from the trust was received in the accounts for the year ended 30 June 1987. It was not recorded in the credit submissions that GSH Finance made an operating loss of $21.7m for the year ended 30 June 1987 and an operating loss of $24.2m in the year ended 30 June 1988 (net of extraordinary items).

No assessment was made of the ability of GSH Finance to meet a margin call in the event of a shortfall in share cover. No analysis was made of the value of Hooker shares in the credit submission of July 1986, even though they were to constitute the main security. No attempt was made to analyse the implication of the operating loss for the previous year, and an 80% increase in assets by revaluation.

There was little analysis in the credit submission of July 1988 of the long term prospects of the borrower and the security, even though the submission would extend the facility by 2½ years. Financial information in the credit submission merely repeated figures from financial documents, with no analysis.

(xix) GSH Investments - Undue reliance was placed on sale of assets and/or refinance as a source of repayment. Security, in the form of shares in Hooker, was inadequate. Hooker shares would have been difficult to liquidate as security. In July 1988 the security was amended to include cross-collateralisation with the GSH Finance and Hersfield facility, but there was insufficient equity available to cover the security shortfall on either the GSH Finance or GSH Investments facilities.

The credit submission in September 1986 included financial information about the Herscu group on a consolidated basis, but did not include financial information relating to GSH Investments.
The credit submission in October 1986 contained no financial information about the GSH group. No distinction was drawn between the Hersfield group and the GSH group. No analysis was made of the value of Hooker shares, which were the main security.

The purpose of the credit submission in June 1988 was to extend the facility until 31 December 1990, but it contained little analysis of the prospects of Hooker, following the stock market crash in October 1987. The failure of the privatisation bid by Mr Herscu for Hooker, and a shortfall in security cover of approximately $16m, were not noted.

The credit submission in October 1988 contained no financial analysis of GSH Investments, or of the future prospects of Hooker.

It must be emphasized that the matters listed in the preceding paragraphs are not exhaustive. On the contrary, they do no more than given an indication of the types of deficiencies to be found upon a reading of the transaction reports in volume 3 of this report.

If the directors had had no more than a good general understanding of the assessment of credit risk, they could hardly have missed noting the more glaring deficiencies in the credit submissions, and their potential significance. Indeed, in the course of evidence directors often conceded the obviousness of deficiencies, when confronted with particular credit submissions. Sometimes, however, it was explained by a director that he must have, or had in fact, noted the deficiency, sought further details from Johns, received an assurance that all was in order, and approved the submission on that basis.

(e) The quality of approvals

The quality of decision making by the directors, when approving credit
submissions, was directly related to the quality of the submissions. In the view of the Commission, it is beyond argument that many of the credit submissions were of poor standard.

To the extent that doubts were expressed about particular lending proposals, those doubts were mostly confined to concern expressed by Ryan after mid-1988 about lending further, or at all, to certain borrowers. On several occasions Mr Moyle and Mr Carr expressed reservations about the terms of proposals, but ultimately approved them anyway. Very shortly before the collapse in May 1989, strong concern was expressed by both Mr Ryan and Mr Moyle about the need to adopt a more conservative lending policy. That, of course, was years too late.

In the vast bulk of cases, directors as a whole were not critical of credit submissions with substantial defects, nor, of course, were they critical of their own lending policies, or the credit risk management systems which produced the submissions. Approvals by directors were characterised by acceptance of, or at least acquiescence in, management's recommendations, rather than critical evaluation of the submissions.

Mr Moyle produced to the Commission a record kept by his personal assistant of all of the credit submissions that came to him for approval. This showed whether the credit proposal was approved by Moyle or by Carr, and provided details of the date that the credit submission was received, and the date upon which approval was relayed to Tricontinental. (It should be noted that the record included money market proposals, as well as lending ones.) Analysis shows that, in the period 1 July 1986 to May 1989, each of these directors approved unconditionally almost 97% of the proposals sent to them, and declined to approve a little over 2%. Nine of the proposals declined by Carr were declined in March and April, 1989.
Mr Moyle

<table>
<thead>
<tr>
<th>Year Ended 30 June</th>
<th>Approved</th>
<th>Approved Subject to Conditions</th>
<th>Declined</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
</tr>
<tr>
<td>1987</td>
<td>263 99.6</td>
<td>- 0.4</td>
<td>1 0.4</td>
</tr>
<tr>
<td>1988</td>
<td>228 95.7</td>
<td>4 1.7</td>
<td>6 2.6</td>
</tr>
<tr>
<td>1989</td>
<td>56 87.5</td>
<td>3 4.7</td>
<td>5 7.8</td>
</tr>
<tr>
<td>TOTAL</td>
<td>547 96.6</td>
<td>7 1.2</td>
<td>12 2.1</td>
</tr>
</tbody>
</table>

Mr Carr

<table>
<thead>
<tr>
<th>Year Ended 30 June</th>
<th>Approved</th>
<th>Approved Subject to Conditions</th>
<th>Declined</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
</tr>
<tr>
<td>1987</td>
<td>125 100</td>
<td>- 0.0</td>
<td>- 0.0</td>
</tr>
<tr>
<td>1988</td>
<td>250 99.6</td>
<td>- 0.4</td>
<td>1 0.4</td>
</tr>
<tr>
<td>1989</td>
<td>265 93.0</td>
<td>5 1.8</td>
<td>15 5.3</td>
</tr>
<tr>
<td>TOTAL</td>
<td>640 96.8</td>
<td>5 0.8</td>
<td>16 2.4</td>
</tr>
</tbody>
</table>

The extremely low rejection rate by Moyle and Carr, as shown by the above table, is consistent with Moyle’s belief that only matters of principle were to be settled at the approval stage.

Explanations given to the Commission by directors oscillated between two propositions, neither of which is sustainable. One is that the submissions were in fact generally adequate. The evidence strongly contradicts that proposition. If directors in fact held that view during the period 1986-1989, then that discloses a clear lack of perception. A Tricontinental director did not need to be a specialist corporate banker in order to perceive the inadequacy of the submissions, or to appreciate their significance. Nor did he need to have foresight equivalent to today’s hindsight. Having seen for itself the defects in the submissions examined in evidence, the Commission is firmly of the view that the great bulk of defects should have been plain, at the time, to these particular directors, and indeed, to any other reasonably skilled general
banker, accountant or senior corporate executive, if required to apply his or her mind to the subject of credit approval.

The other explanation given by directors is that they were aware of some deficiencies in the submissions, but either they were entitled to assume that management and staff had done their job properly before submitting credit proposals for approval, or they (the directors) had received explanations or assurances from Mr Johns. This was put forward in the context of a strategy of high risk lending for high reward, which was recognized in November 1984 (see para 15.111), May 1986 (paras 15.130-132) and June 1986 (para 15.134) as calling for the exercise of high calibre lending skills by management and staff.

In the Commission's view, these two explanations represent a choice between neglect and abdication of responsibility. The point has already been made that the approval of major credit transactions was not simply a board formality. Submissions to the contrary by counsel for the directors are not accepted by the Commission. The so-called 'non-executive' directors undertook a specific and vital 'executive' task. Each had an individual responsibility to ensure that he had adequate and accurate material before him, so that a properly informed decision could be made on each submission. When vital information was missing, it was not good enough to assume that management would have it covered. A credit risk simply could not be assessed without the information.

The Commission makes the following findings about the approval of credit submissions by Tricontinental’s directors:

(i) The directors undertook an important function - the approval of all credit submissions for more than $6.5m. It was a heavy burden, and accounted for more than 90% (by value) of new or increased credit facilities provided by Tricontinental in the period 1986-1989.

(ii) Directors conducted this activity under delegation. Four directors, or the directors available "on the day", were required. Submissions were
considered on a round robin basis, instead of at a meeting. Consultation took place between directors, or between one or more directors and management, on some occasions, but most of the decision-making was done by directors acting individually.

(iii) Approvals were communicated to management by each director. The transactions went to the next board meeting for ‘formal confirmation’, but in reality that was little more than a noting exercise, and implementation of credit facilities was not conditional upon confirmation.

(iv) Mr Johns participated in almost all approvals, but the effective result of the round robin system was that most of Tricontinental’s lending was authorized by non-executive directors who were not sufficiently qualified to act alone, except for Mr Moyle and, to a lesser extent, Mr Ryan. The round robin system deprived directors of the mutual support that was necessary to compensate for their individual limitations.

(v) Directors referred in evidence to a heavy reliance on management in the preparation and presentation of submissions. For the reasons discussed previously, this was a mistaken trust in the system. There was a lack of proper criteria for the assessment of credit risk, the influence of Mr Johns in pushing for volume of lending precluded balanced appraisal, and the submissions to directors were akin to selling documents, designed to ensure board approval. Urgency of preparation, and quick turnaround by directors, were the hallmarks of the system.

(vi) As a result, the quality of the submissions was often poor. In some cases, omissions had the effect of misleading the directors. In many cases, necessary information was absent or deficient.

(vii) Major defects included the lack of critical evaluation, the absence of cash flow analysis and projections, and the paucity of other information relevant to credit risk. There was failure to include relevant information available in Tricontinental’s own files (especially as to past
default), or to update information that was obtained from the files.

(viii) Further, there was heavy reliance upon security (but without adequate analysis of its real worth), on continuing inflation of asset values, on 'takeout' for short term facilities, and on 'name lending'. The willingness to meet clients' needs led to loan structures which left Tricontinental poorly secured.

(ix) The transaction reports vividly illustrate the shortcomings in Tricontinental's evaluation and management of credit risk. These shortcomings are reflected in the credit submissions approved by directors. The transaction reports reveal much about how poorly the directors performed their task by approving those submissions. For the most part, inadequate financial information and analysis was accepted without question, and was acted upon by directors.

(x) The situation is clearly distinguishable from one where non-executive directors may be entitled to rely upon information put to them by management, in the absence of reason for suspicion, to enable issues of policy to be determined. In this matter, Tricontinental's non-executive directors descended into the executive arena itself, and undertook one of the most important tasks.

(xi) Each of the non-executive directors possessed substantial skills and experience in at least one or more areas of general banking, accounting or senior corporate executive management.

(xii) In the circumstances, it is not necessary to test the limits of what might be expected of a director without any particular skills. The skills that each of these directors did have, were more than enough to ensure that they were capable of recognizing the more obvious deficiencies in the credit submissions. That was enough to put them on notice as to the less blatant ones. The directors either failed to see the danger signals when they should have, or they did see them, but chose to ignore them.

(xiii) The Commission finds that the directors did not act competently when approving credit submissions.
The handling of investment banking matters by directors raises a separate set of issues, which are considered later in this chapter.

F. Monitoring of Credit Transactions

(a) Introduction

The first report, at paras 22.86-111, outlined the categories of reports provided to Tricontinental's management and board. The reports supplied information, and served as monitoring tools. Paragraph 22.111 notes that the adequacy of the reports remains to be considered. That issue is the subject of this section. Attention is confined to the more troublesome areas of reporting:

- large exposure reports
- lending secured by shares
- problem loan reports.

(b) Large exposure reports (first report, para 22.102; see also paras 11.305-307 above)

Lists of Tricontinental's largest exposures were provided to directors on three occasions:

- In July 1986, a summary of clients with committed facilities in excess of $5m as at 31 May 1986.
- In July 1987, a list of the largest 30 exposures as at 28 July 1987.
- In October 1988, a list of exposures of $35m and over as at September 1988, categorised according to whether the facilities were "in order" or "not in order".

The reports to the board on large exposures used a curious methodology to determine group exposures (first report para 22.60). As attachments 22C and 22D to the first report demonstrate, the application of this methodology meant that some group exposures were shown as being significantly lower than they actually were. A clear example is the facility to Metals Exploration Limited for $164m (approved August 1987). In the large exposure reports for 31 December 1987 and 29 February 1988, this committed facility was discounted.
to $68.1m, reducing the (apparent) total exposure to the Bond group by almost $100m. While the large exposures report did contain the actual figures for exposures to subsidiary companies and showed how the exposure was discounted, for group purposes, in proportion to the shareholding of the parent company, the discounted total was probably the one to which directors would refer, especially as it was the figure used in the summary of exposures which formed the cover sheet to the report.

As submitted by counsel for Tricontinental, the methodology was misconceived, in as much as it failed to recognise that Tricontinental was exposed to a member company of a group of companies for the full amount lent to that company, whatever the proportionate shareholding held by its holding company. The effect of the methodology was to misrepresent, by understating, the extent of Tricontinental's exposures to groups of companies.

A further point about the reporting of large exposures is that, unlike SBV, Tricontinental did not have any system for reporting the total exposure to a client (or group) across the range of Tricontinental's activities eg, lending, underwriting and investment. Because of the lack of co-ordination of this information, only Johns had the full picture of Tricontinental's relationships with clients, and the cumulative risks they involved.

(c) Lending secured by shares (first report, paras 22.93-96; see also paras 11.294-303 above)

Directors requested and received two types of reports about Tricontinental's loans secured by shares. The first was a schedule entitled "Listed Equities for Margin Lending". At the March 1987 board meeting, directors requested that they be provided with a schedule of the shares held by Tricontinental as security for loans, identifying the company in which the shares were held, the proportion of the company's share capital held as security, the market value of the shares, the average monthly turnover in the shares, and the name of the borrower or borrowers (but not the amount borrowed). This report was

The report was described in evidence by Moyle as being very lengthy, and not particularly helpful. The most significant failing was that it did not disclose the amount of the loans which were secured by the shares listed, and so did not allow directors to identify when the security cover provided by the shares might be in breach of covenants. Accordingly, omissions from the reports referred to below, regarding loans in default of security cover covenants, could not be identified from the schedule of listed equities for margin lending, unless the reader knew independently the amounts of the loans secured by particular shares.

The second type of report about loans secured by shares was entitled "Lending Secured by Listed Shares". In November 1987, Johns presented a report to the board which identified those loans secured by shares which were in breach of security cover, and for which top-up had not been received. Similar reports were presented in February, March, June and July 1988. These reports were not only sporadic, but also seriously deficient. They did not identify numerous facilities in respect of which security cover was inadequate and unrectified. The following numbers of facilities were identified as being in default:

<table>
<thead>
<tr>
<th>Month</th>
<th>Number of facilities named</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 1987</td>
<td>7</td>
</tr>
<tr>
<td>February 1988</td>
<td>15</td>
</tr>
<tr>
<td>March 1988</td>
<td>14</td>
</tr>
<tr>
<td>June 1988</td>
<td>16</td>
</tr>
<tr>
<td>July 1988</td>
<td>13</td>
</tr>
</tbody>
</table>

In contrast, on 22 December 1987 a list of sixty-four companies, produced to the internal auditors, showed that twenty-nine of them were in default of their
security covenants for share cover; see further para 13.53 above. As examples of omissions, the March 1988 report had some notable absentees. These included Atoll (security deficiency as at 3 February 1988 was $7m), Metals Exploration ($53.1m), and Smith & Lane ($8.7m). As late as July 1988, the report still failed to name Atoll.

Given the extent of Tricontinental's exposure to equity securities, and the magnitude of the security shortfall following the stock market crash (upwards of $200m by early 1988), this level of reporting was obviously inadequate. As submitted by counsel for Tricontinental, the failure by a borrower to meet a top-up call, resulting in the continuation of a security shortfall, should have been seen as an indication of potentially serious problems with the facility. Often, the continuance of the security deficiency would raise doubts about the ultimate recovery of the facility. It both demonstrated the borrower's inability to find funds to rectify the security default, and underlined Tricontinental's vulnerability in the event that the facility was not repaid and the security had to be enforced.

(d) Problem loans reports (first report, paras 22.87-88; see also paras 11.275-291 above)

Each month the board received a report on Tricontinental's 'problem loans'. This report included summaries of loans currently in default, showing in each case the amount of the loan, the security held, the reason for default, the current status of the loan (whether or not interest was still being accrued), and management's estimate of the likely loss. The report also showed the total value of problem loans, the total value of non-accrual loans, and an estimate of total losses. The previous month's figures were provided for comparison. A separate list showed loans for which interest had been unpaid for one to two months. Loans which had been the subject of some activity in the previous month were identified.
Problem loans reports underwent a number of refinements between April 1985 and May 1989 at the request of the board. For example:

**Board Meeting**  
19 April 1985  
Instruction  
Board requested monthly summary of problem credits over $100,000 "in a format that is easy to read", together with rating of recovery prospects and estimate of anticipated loss.

22 January 1986  
Moyle requested that the total of non-accrual loans be incorporated in the monthly summary of arrears/default loans.

23 April 1986  
Summary of non-accrual loans to identify facilities that had been added since the previous month.

27 January 1988  
Board requested that distinction be shown between facilities on which interest is suspended and those on which it is still accrued.

At the meeting on 18 November 1987 (the second meeting held after the stock market crash on 20 October 1987) the board considered a report by Johns on lending secured by equities. In part the managing director's report stated as follows:

"*Lending Secured by equities*

Following the dramatic fall in world wide equities markets in mid October, 1987, continual contact has been maintained with all Tricontinental clients secured by equities. Systems are monitored three times daily with contact being made with clients on a daily basis to effect full or part margin calls as so desired. It is considered extremely important at this point in time to maintain daily contact with clients and to discuss their problems and not to place clients under any undue pressure to force sale of equities. The market has recovered somewhat during the past 4 business days however the majority of experts consider further falls in equity markets may occur during the next few weeks. All clients to date, excluding those detailed below have provided top up securities in the form of other equities, cash and/or other assets:--"
Then followed a list of seven corporate clients with security shortfalls, with a brief note on the measures proposed for top-up or other security in each case. No immediate problems were envisaged.

15.393 It has been submitted to the Commission by counsel for directors that this report was totally misleading as to the true position of the defaulting loans secured by equities after the stock market crash, and that the report as to the seven listed was unrealistically optimistic and wholly inaccurate.

15.394 At the board meeting on 16 December 1987 Rawlins requested a full list of loans in default where clients had not maintained security values for lending secured by equities. At the meeting on 27 January 1988 the board agreed that the format of the credit reports would be amended to distinguish between facilities on which interest was suspended and those on which interest was still accruing. Directors asked that details concerning security and its location be included in the description of each facility.

15.395 The minutes of the meeting on 24 February 1988, under the heading relating to discussion of credit reports, record that:

"Mr Rawlins raised his concern with management's cavalier attitude to doubtful debts as the Board was not always fully informed."

That entry followed a series of concerns, queries and requests for information by Rawlins, recorded in the minutes for the meetings in November and December 1987. The lack of effective response led to Rawlins' resignation in April 1988 (see para 15.71 above). A full twelve months later, at the meeting on 26 April 1989, some other members of the board belatedly recognised the need for revised lending policies (see para 15.155 above).

15.396 Examples of defects of a general nature in the problem loans reports are listed below:
Hunter said that, between July 1988 and May 1989, Johns requested that certain loan exposures, totalling over $106m, be omitted from the problem loans report (see first report, para 22.88). Johns apparently took the view that a loan could be in default, and yet not be a 'problem', if he had some workout arrangement in prospect (Smith & Lane was the clearest example; see paras 11.284-288).

The default loans related only to monetary defaults - the failure of a client to service or repay its loan - and did not identify loans in which there was a breach of the security cover covenant, or some other covenant.

The reports received by the board necessarily relied to a considerable extent upon management's subjective assessment or judgment.

Management's estimates of the likelihood of losses provided in the monthly reports, and in the annual provisioning reviews, can only be described as very optimistic (eg, Atoll, Rocado, the $64m "worst case scenario" in May 1989).

The schedule of loans secured by shares for which security cover top-up was not received, was substantially understated.

The problem loans report did not draw together the individual exposures to member companies of corporate groups. It was an important piece of information for directors to know that there were problem groups and, in particular, to know what the total exposure was to such groups. A grouping of the exposures would have given directors a quite different sense of the magnitude of the risk faced by Tricontinental.

An example submitted by counsel for Tricontinental was that if the DAC/Boley group of exposures (ie. Boley Holdings, Bosane, Churchill Leisure, Amaldela and Lidala), which were in default at July 1987, had been grouped together and shown in the problem loans reports as an exposure to a group of companies, the directors would have been made aware that, at July 1987, this group of defaulting facilities accounted
for approximately 60% of all Tricontinental's corporate facilities in default at that time. Similarly, the DAC facilities make up almost 50% of the total non-accrual loans as at March 1988. Moyle gave evidence that, unless it was clear on the face of the problem loans report, he was not able to identify these exposures as group exposures or related exposures. Moyle agreed that, in the ordinary course of reporting, he would have expected companies that were associated in some way with each other to be grouped accordingly.

Examples of defects in the reporting of specific problem loans are given below:

(i) Atoll - When this was first reported as a problem loan, in June 1988, the board was given assurances about the $13.2m facility based on information which Mr Johns had received from the guarantors of the facility, Mr Sng and Mr Peh. To describe these as persons of substance, and to say that no loss was envisaged, was "flagrantly misleading", according to Mr Weaving. The report to the board meeting in December 1988 still assured that no loss was envisaged, yet, at the very same board meeting, a $6.5m write-off was made.

(ii) Rocado (RIFL) - Although RIFL was unable to effect dividend payment on the preference shares due 1 July 1987, Tricontinental's board papers continued to assert that no loss was expected, due to the pending sale of DAC shares held as security. In October 1987, when the Tricontinental board was told of negotiations with Duke to purchase the DAC shares held by Tricontinental as mortgagee in possession, the board was not told that the market price of the DAC shares was 50c. Instead, the board was told that the sale of the shares at 70c would clear RIFL's debt. The board was told that the matter was under constant review, and no loss was expected.

(iii) Smith & Lane (SLH) - Although the SLH facility was treated as being in default from July 1988, when SLH failed to meet interest payments, the facility was not reported to the board as being in
default until June 1989. A total of $2,780,236 in interest had been accrued from the date of default and taken into profit. As a result of not being included in the reports of problem loans, those loans were understated by $20m from August 1988 until June 1989.

(iv) Churchill Leisure, Amalda - Problem loan reports from February 1988 onward misdescribed the value of the security (charge over shares).

(e) Performance by directors

The Commission makes the following findings about the monitoring of credit transactions by Tricontinental's directors:

(i) The standard of reporting to the board about the state of credit facilities was seriously deficient. To a large extent this reflected a deep reluctance by Mr Johns to tell the board bad news - he would attempt to trade his way out of a situation rather than make appropriate and timely disclosure to the board. This led to the extension of many loans in the hope that, somehow, defaults would be remedied. Omissions and errors included:

- failure to report variation of facilities from the approved basis (including unauthorised variations to the borrower, the security, the amount and the term);
- failure to report breaches of security cover and other covenants to the board;
- provision of misleading information to the board regarding prospects of recovery of loans in default; and
- failure to report loans in default.

(ii) As a result, directors were less fully informed than they were entitled to be. The lending reports gave the directors false comfort. The greatest dangers lay with the problem loans which were not reported. Thus even the report prepared on 20 May 1989, which referred to the prospect of $64m in bad and doubtful debts on a 'worst case scenario', came as a profound shock.
(iii) In principle, the directors were entitled to rely upon the reports provided by management, in the absence of grounds to suspect that they were not correct.

(iv) However, following the stock market crash in October 1987, Mr Ryan had suspicions that the board was not getting the full story on problem loans. Mr Rawlins resigned in April 1988 because he felt that Mr Johns was not giving the board adequate information. Other board members had heard Rawlins' complaints at board meetings, and Rawlins had discussed the matter privately with Mr Moyle. Defects which were readily apparent in credit submissions for new or extended transactions should have aroused suspicions about the standard of reporting on existing transactions.

(v) Despite these grounds for suspicion, the board continued to accept both the written and oral reporting as generally satisfactory.

(vi) Had the board probed, serious defects in reporting on credit transactions would have been revealed.

(vii) The absence of true and full information in the reports to the board must have contributed greatly to the failure by the board to take adequate and timely prudential measures in Tricontinental's lending policy and operations.

(viii) The absence of information was primarily the fault of management, and in turn that was almost entirely the fault of the managing director, who directed the contents of most reports, and through whom all reports were filtered.

(ix) The board, however, must also accept its share of the blame, due to its lack of perception and its generally compliant acceptance of inadequate reports.

G. Approval and Monitoring of Investment Banking Transactions

(a) Introduction

15.399 The operating guidelines for investment banking, dated December 1984, stated that those activities would provide Tricontinental with increased fee revenue
and potential for sizeable capital profits. This objective was repeated in later versions of the guidelines.

Tricontinental’s 1988 budget stated that the company “actively seeks participation in existing businesses and new business ventures. Investments have been placed in a wide range of Australian listed and unlisted companies”. As shown below, Tricontinental’s investment banking activities were also a means of providing finance to its clients. Investment banking commitments were included in the total loan commitments reported to the Tricontinental board on a monthly basis.

Broadly speaking, Tricontinental’s holdings of shares as a result of its investment banking activities were of two quite distinct types.

(i) The first was those shares which Tricontinental purchased and held as investments in its own right, and in respect of which it was entitled to the profits from resale of the shares, and ran the risk of loss if the shares went down in value. The shares were, from July 1986, classified as “category B” investments, and were divided into long-term and short-term portfolios. On occasion, from October 1987, the short-term portfolio was designated as “category C”.

(ii) The second circumstance in which shares were held by Tricontinental was that in which the risks and benefits of ownership of these shares lay not with Tricontinental, but with a client. These shares were, from July 1986, classified as “category A”. Although Tricontinental funded the purchase of the shares, and was the registered owner of them, special arrangements were entered into - usually involving put and call options - pursuant to which the client paid the holding costs of the shares, protected Tricontinental from loss if the shares went down in value, and was entitled to the profits made on resale of the shares. In some cases profits on resale were shared between the client and Tricontinental.
Some of the category A investments have been examined by the Commission. In relative terms, they were not a major source of Tricontinental’s losses, but they provided an important insight into Tricontinental’s procedures and practices. It was also relevant for the Commission to consider whether there had been any illegal conduct. The Commission examined in public the details of seven investment banking transactions, and eleven others were reviewed privately. Almost all were either category A transactions, or were associated with them, or involved Tricontinental in financing the acquisition and holding of shares by a company ‘friendly’ to Tricontinental.

(b) Nature of category A transactions

No doubt each category A transaction had its own features, but there were certain usual features:

• Tricontinental purchased shares with its own funds and in its own name.

• The shareholding was subject to an arrangement with a client (inaccurately, but conveniently, called a ‘third party’).

• The arrangement typically involved agreement by the client -
  - to pay holding costs to Tricontinental for the shareholding, at an agreed rate;
  - to protect Tricontinental from any capital loss on the transaction. This was usually achieved by put, or put and call, options for the shareholding, at an agreed exercise price the same as or higher than Tricontinental’s cost price. Some directors used the expression ‘put and call’ as a shorthand way of referring to profit sharing arrangements as well.

The reason for separating category A from category B ‘investments’ in board reports was explained by both Mr Morton and Mr Ryan. Before July 1986, directors received a single list of long term ‘investments’ held by Tricontinental, with information as to original cost price and current market price. The true significance of an increase or decrease in market price could
not be appreciated unless it was known whether there were other arrangements. After July 1986, shares subject to special arrangements were classified as category A, and shares held as investments (long and short term) were classified as category B.

15.404 Directors differed in their evidence as to the true nature of a category A shareholding. Mr Smith took the view that it was one where Tricontinental bought shares with its own money, on its own account and in its own name, and there were side or collateral agreements designed to indemnify or guarantee Tricontinental against any loss. Put and call options were a form of security. He disagreed that a category A transaction was a quasi-loan to a client. Smith did not believe that Tricontinental was "marketing a service", but he did accept that the initiative for category A transactions came from the client. Moyle's understanding was that the transactions were investments, in which the put and call options protected Tricontinental from down-side risk in a market decline, but limited the up-side potential for gain.

15.405 Mr Ryan considered that category A transactions were a financial product. He said that Johns explained that category A transactions were a product provided to assist the clients. There did not seem to be anything very strange, to him, about a put and call arrangement. He thought there were plenty of cases amongst merchant banks where such a product was offered. Mr Carr said that the only reason why the shares in category A transactions were purchased by Tricontinental, and then held in Tricontinental's name, rather than being held in the name of the client, was that it was a form of service and a method of offering a product, i.e. a lending product, to the client. He said he agreed with Ryan that it was a product that was beneficial to Tricontinental. It was an income earner and that was his main concern. He noted that in the financial market there were many ways of providing financial accommodation. Category A transactions were another way of doing that.
Mr Rawlins declined to generalise. He accepted that category A transactions were segregated because there was another party involved; it was common for Tricontinental to enter into put and/or call option agreements with the 'third' party; in some cases there were profit sharing arrangements; in most cases the third party agreed to recompense Tricontinental for its holding costs; and in some cases the third party would bear any loss. The beneficial interest in the shares would be either with the client or Tricontinental, depending upon the situation.

Mr Morton considered that the shares held in Tricontinental's name were, in truth, beneficially held for a third party, subject to the put and call options. The general tenor of Mr Ziebell's evidence was that category A transactions were simply a method of making loans on the security of shares. "I saw them as an extended lending transaction, like a put and call; we held the shares for the client." He also described the category A transactions as "a service to clients" and a "quasi loan". He expanded on this by saying that these transactions were "a loan by another name".

Perhaps the last word belonged to the director best placed to know the true position. Johns said in evidence that the category A transactions were basically financial arrangements made on behalf of clients, usually by means of related put and call options.

Directors were asked why clients would enter into category A transactions. Smith said that it had never occurred to him to consider why a client would want shares to be purchased in Tricontinental's name. Ryan also said that he had never really thought about it from the client's point of view. He speculated that a client might not want "it" (presumably, a loan for the purchase of shares) on its balance sheet, because it might affect gearing.

Carr was another director who had not given deep thought to why a client would seek to use such a service. He acknowledged that one of the effects of
the service was that a client would be the beneficial owner of the shares, but that ownership would not have to be disclosed.

Morton said that he did not inquire as to the client’s motives for entering into category A transactions. He believed that the background to the transactions would have been contained in the credit submissions, but he really had no idea of the clients’ purposes.

Ziebell was not aware of having given any direct thought to the purpose of the transactions, but referred to the balance sheet aspect, and also the possible desire for anonymity.

All this apparent lack of curiosity by directors was against the background of Moyle repeatedly seeking assurances from Johns that the transactions had been checked for legality.

Mr Rawlins suggested reasons why clients might request Tricontinental to enter into category A transactions - tax planning for dividend rebates, balance sheet purposes, anonymity, flexibility, and the elimination of administrative hassles. He understood from questions that were asked from time to time at board meetings that the legality of tax planning arrangements had been checked.

As to anonymity, Rawlins said in certain cases people do not wish to declare their holding to the public. There may be competitive reasons. He said he did not think it was unusual for people to use a nominee company. He agreed that on no occasion was Tricontinental acting as a nominee company, in the usual sense, in a category A transaction. He did not see that there was anything particularly sinister in somebody, in effect, using a category A type of arrangement. He agreed that during the period leading up to, and just after, the October 1987 stock market crash there was a lot of takeover-related activity.
The directors agreed that category A transactions generated good profits. Profit was clearly the motivating force in Tricontinental making the service available to clients. Smith put the matter in the following terms:

"All I know is that, as far as we were concerned, it was good business. There was a profit and it was acceptable to the board. ... I did not receive any suggestions that there was anything untoward. On the contrary, it was acceptable business. It was carefully and fully explained to board members and accepted, as I say, as part of the business."

The Commission makes the following findings about the nature of category A transactions:

(i) Category A transactions were, in substance, financing arrangements in which Tricontinental earned profits equivalent to a lending transaction, and occasionally received a profit share. In effect, the category A shares represented security for a loan, with Tricontinental's status as the registered owner of the shares amounting to a legal mortgage of the shares.

(ii) The motivation of clients for the category A transactions were various. Some were motivated by taxation planning considerations; some sought the anonymity associated with having the shares registered in Tricontinental’s name; and some were motivated by financial reporting considerations, using the category A arrangement to keep debt ‘off balance sheet’.

(iii) In providing this service, the directors were essentially motivated by the good profits that were to be made.

(c) Investment banking guidelines

Although category A investments were in substance loans, they were not regarded by Tricontinental’s directors or management as being subject to the operating guidelines for lending secured by shares, described at paras 15.222-282. To the extent that guidelines were applied, they were the operating guidelines for investment banking generally.
These guidelines were adopted in November 1984, modified on several occasions, and published in the same way as the operating guidelines for lending. A number of changes were made to the guidelines in December 1985, and for present purposes that is a more convenient starting point than November 1984. The December 1985 guidelines for the short term trading portfolio were:

- Limit of $1.0m on total portfolio.
- Limit of $200,000 on any one stock.
- Purchases and sales up to $200,000 at the discretion of the investment manager, in consultation with the general manager lending and/or the managing director. Later guidelines were silent as to who might exercise this discretion.

The December 1985 provisions for investment banking (other than the short term trading portfolio) included the following:

- Initial ceiling of $50m, with no more than 20% in any one industry or stock unless guaranteed takeout was provided.
- All proposals over $200,000 were subject to formal approval by an investment banking credit committee comprising the group managing director, investment manager, general manager lending and corporate services, and general manager money market and international services.
- Discretion limits for approvals, which corresponded broadly, but not precisely, with lending transaction discretion limits:
  - up to $500,000 for each of the above general managers;
  - up to $1.0m for the two general managers acting in agreement;
  - up to $5.0m for the credit committee, group managing director and one other director, acting in agreement;
  - over $5.0m required approval by "available directors".
- All transactions were to observe AASE and NCSC regulations. Holdings in excess of 10% of issued capital to be disclosed. Holdings to be restricted to maximum of 20% to avoid the need to make formal takeover offers.
Later guidelines for investment banking deleted the reference to a ceiling of $50m, and the industry and stock limits. The constitution of the investment banking credit committee also changed. From February 1987, it became the group managing director (Johns), the general manager corporate services (Green), and the assistant general manager credit and securities (Stott).

Most significantly, the approval discretion limits were increased, particularly those for the managing director. Until March 1986, the managing director had no delegated discretion to act alone. Then Johns was granted a discretion up to $3.0m per transaction. This increased to $5.0m, if exercised in conjunction with one non-executive director. In February 1987, Johns’ discretion limit was increased to $6.0m per transaction, in line with his lending discretion. It increased to $6.5m, if exercised in conjunction with one non-executive director. Beyond those limits, approval was required by "four directors including the managing director or all available directors on the day".

The guidelines provided that all credit submissions "already approved" between meetings were to be submitted to the board meeting for "formal confirmation".

The Commission makes the following findings about the investment banking guidelines:

(i) The guidelines were extremely sparse.
(ii) They were silent about the types of shares suitable for investment.
(iii) The size of most investment banking transactions meant that the selection of shares, in both category A and category B, was effectively left to Mr Johns. This meant, in turn, that the exercise of judgment and the conduct of Tricontinental’s investment banking business was built upon a very narrow base.
(iv) The guidelines were silent about the nature and extent of arrangements that could be entered into in category A transactions.
(d) Control by Johns

Tricontinental had an investment and funds management division (originally a sub-division of corporate services). Its principal function was to act as portfolio manager for investment and superannuation funds of Tricontinental's clients, but it did conduct some of Tricontinental's own short-term trading portfolio activities (first report, para 19.25).

However, except for some short term trading, Tricontinental's investment banking activities were quite separate from the investment and funds management division. If anything, they were more closely aligned to the activities of the lending division, but they were separate from that too. The investment banking activities were not formally identified as a separate division, or sub-division, of Tricontinental's operations, but they were regarded as a separate 'profit centre' which, for all practical purposes, fell under the direct management of the managing director, Mr Johns.

It some respects, however, these activities were treated as though they did constitute a separate division. As noted at para 19.7 of the first report, the activities were subject to discrete board approved delegated authority guidelines and limits; credit submissions were prepared and presented to the board for 'formal confirmation' under the designation of 'investment banking'; the full portfolio of shares held by Tricontinental was reported to the board each month; and although investment banking facilities were included in Tricontinental's total loan commitments for reporting purposes, separate budgets were prepared for the investment banking business.

In evidence Smith, Rawlins, Green and Stott all said that most of the investment banking facilities were approved by Johns under his delegated discretion. Johns agreed that these activities principally fell under his management.
There is no suggestion in the evidence that Mr Johns sought independent advice about buying or selling any of the shares or other assets in which Tricontinental invested. (He himself stopped giving evidence before any specific investment banking transactions were examined in public hearings - see chapter 3.)

The evidence available does not suggest that Mr Johns had any particular expertise, by training or experience, in sharetrading, such as to qualify him to conduct Tricontinental's substantial investment banking activities virtually single-handed.

Mr Johns' background is set out in chapter 13. There is nothing of relevance to investment banking before he joined Tricontinental in 1980. Once there, he made rapid progress on the lending side of the business, and became general manager lending in 1982. In addition, however, he became general manager corporate services in 1983-4. It is likely that he had his first real exposure to investment banking in the latter capacity. At that time, the management of investment funds was still a function of the corporate services division. It was not until 1988 that the new investment and funds management division was formed.

The extent of Mr Johns investment banking activities during 1984 and 1985 is not clear. However, Tricontinental's annual reviews show that from 1984 it was actively seeking investment opportunities in existing businesses and new business ventures. Paras 8.47-58 discuss the classification of the investments that were made. Some were 'pure' investments, and others were in direct or indirect support of clients - more in the nature of lending products.

What is clear is that from at least January 1986, when Mr Johns became managing director, the investment banking function was firmly in his grasp, and remained there even when the new investment and funds management division was formed in 1988.
It is clear that board members were content with Johns’ close control over investment banking activities. For example, Moyle said that he was aware that Johns handled most of the negotiations with clients, and he didn’t expect that anybody else would have been handling them. In the case of put and call options, Johns was the only one who was in a position to have any realistic assessment of what the merits of the transactions were. With the aid of hindsight, Moyle still believed that Johns’ $6m limit for investment banking matters was satisfactory. He was "quite happy" that Johns should keep investment banking matters under his personal control.

Similarly, Carr said that he did not see it as unusual that Johns controlled a number of category A transactions - it was no different from the close association that Johns had with a number of borrowers. Carr felt that Johns was very knowledgeable about the transactions.

Commission staff have examined the investment banking credit submissions, in order to check the evidence that a high proportion of approvals were made by Johns under his discretion. The results were not available in time for presentation before the conclusion of the evidence, but they are set out below for information. The figures are for the period January 1986 - May 1989, Mr Johns’ term as managing director.

**Investment Banking Approvals**
(by number)

<table>
<thead>
<tr>
<th>Source of Approval</th>
<th>Total number</th>
<th>% of total number</th>
</tr>
</thead>
<tbody>
<tr>
<td>General manager</td>
<td>3</td>
<td>1.28%</td>
</tr>
<tr>
<td>Credit committee</td>
<td>5</td>
<td>2.13%</td>
</tr>
<tr>
<td>Managing director</td>
<td>208</td>
<td>88.5%</td>
</tr>
<tr>
<td>Directors</td>
<td>19</td>
<td>8.09%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>235</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>
### Investment Banking Approvals

(by value)

<table>
<thead>
<tr>
<th>Source of Approval</th>
<th>Total value ($'000)</th>
<th>% of total value</th>
</tr>
</thead>
<tbody>
<tr>
<td>General manager</td>
<td>625</td>
<td>0.18%</td>
</tr>
<tr>
<td>Credit committee</td>
<td>3,000</td>
<td>0.87%</td>
</tr>
<tr>
<td>Managing director</td>
<td>231,984</td>
<td>67.35%</td>
</tr>
<tr>
<td>Directors</td>
<td>108,853</td>
<td>31.60%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>344,462</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

15.433 These tables support the view that Johns approved the great bulk of investment banking facilities by number (88.5%), but the directors approved a significant proportion by value (31.6%), although nowhere near the very high proportion of lending credit facilities approved by them (over 90% by value).

15.434 Examination of submissions showed that, out of the total of 235 investment banking approvals, 185 were granted before the collapse of the stock market on 20 October 1987.

15.435 The above tables do not distinguish between category A and category B investments, so as to enable a direct comparison to be made of the number of category A transactions approved by Johns, and the number approved by the directors.

15.436 The monthly reports by the managing director listed the names of the companies whose shares were the subject of category A arrangements. They show that for the period July 1986 to June 1989 there were 30 such companies (after allowing for name changes). A comparison of the names listed in that exhibit, with the names of the shares in the 19 investment banking submissions approved by directors (para 15.432 above) shows that 13 of the submissions related to shares in companies on the category A list.
It seems almost certain then, that 13 of the 19 submissions approved by directors related to category A transactions. It should be noted however, that in some cases there were several submissions concerning shares in the same company, so that the 13 category A transactions related to shares in only seven companies, out of the possible total of 30.

Mr Johns said that as far as the documentation of credit submissions was concerned, category A investments were not treated any differently from category B investments. Submissions were approved either under his discretion or by the board. When he made decisions, within his discretion, for Tricontinental to purchase shares as an investment, he had credit submissions prepared afterwards to record the matter.

Mr Stott also said that in cases where Johns was exercising his discretion, there was no documentation before the decision. Johns informed Stott of the investment decision after the fact, and asked him to prepare a credit submission confirming the share purchases. The documentation for those transactions generally comprised a front summary sheet together with a recommendation page. Neither page included a reference to the reason for making the investment. Stott said "my understanding is that if a put and call was to be part of that purchase, that would be noted in the security section of that front sheet".

The pro-forma face sheet used for investment banking submissions was the same document as that used for credit submissions for lending facilities, modified only by adding a reference to the fact that the submission was for an investment banking facility.

Investment banking credit submissions tendered in evidence show that there had been a change by early 1986 in the nature of the information provided in credit submissions for the category A type of facilities. Before-change and after-change examples are given below:
(i) A credit submission dated 20 February 1985 set out "J M Messara Financial Services Pty Ltd" in the space for the client's name. The facility was described as investment banking, and the proposed amount was $2m. The purpose of the facility was described as the purchase of shares in Southland Mining Ltd, and the security was stated to be the purchase of the shares in the name of Tricontinental Corporation Limited, a put option for purchase price plus fees from the "borrower", and a personal guarantee from J M Messara. Repayment was to be from cash flow and/or refinancing. The expiry date was 30 June 1986. Fees totalling $600,000 were set out, together with dates for payment, and it was stated that these fees represented a pre-tax return to Tricontinental of 25.5%.

(ii) A credit submission dated 6 March 1986 set out "Australian Racing And Breeding Stables Ltd" (ARABS) in the space for the client's name. The facility was described as investment banking, and the proposed amount was $1.35m. The purpose of the facility was described as the provision of a $1.35m investment banking facility to enable Tricontinental to purchase one million shares in ARABS at a cost of $1.35 per share. The security was stated to be 1 million ARABS shares, currently trading at $1.48. The expiry date was 31 March 1987. Repayment was to be from sale of ARABS shares. Fees were not set out, but it was stated that Tricontinental "will receive a return on its investment of not less than 25%".

Each of these transactions is examined in detail in transaction report 19 in volume 3 of this report.

15.442

In the first example shown above, there was full reference to the name of the client, the shares to be bought in Tricontinental's name, the fact of the put option, and the anticipated return from the arrangement. In the second example, there was no reference to the name of a client, or the existence of any ancillary arrangement, but their existence could be inferred from the statement of anticipated return from the investment, of "not less than 25%".
Further evidence indicated that in fact the second example was another purchase on behalf of a client. A letter dated 11 March 1986 from Johns to Mr J M Messara confirmed a put option and repurchase agreement for the ARABS shares, by which Messara or his nominee ("the purchaser") would repurchase the ARABS shares for the price paid by Tricontinental plus any fees or costs incurred by Tricontinental. Tricontinental was to receive a net return of 25% per annum, based on the purchase price of the shares. Subsequent memoranda and correspondence referred to a 50/50 profit sharing component. (A written submission to the Commission on behalf of Mr Messara denies the existence of that arrangement - see para 15.526 below.)

Mr Johns said that credit submissions recording investment banking transactions were held in the credit area. Documents relating to purchases and sales were held within Johns' secretary's area; the original or a copy would have gone to accounting and a copy would have gone to investments. Documents about put and call agreements were held by Johns' secretary, and also in the securities area. Johns asserted there was nothing within his domain for which there were not copies elsewhere within Tricontinental. This evidence was contradicted by the auditors, Mr Weir and Mr Bray.

Mr Hunter also disagreed with the evidence that investment banking documentation went to the securities area. He said Johns maintained the investment banking documentation, especially where put and call arrangements were involved, and kept a tight reign on that documentation to ensure that access was restricted.

Mr Stott said that the administrative portion of investment banking files was held in Johns' office. That was an area where one could not just walk in, take files out, and do whatever was wanted with them. They were under lock and key.
There was an investment banking credit committee, but its role was slight. It comprised Johns, Green (general manager corporate services) and Stott. Stott said that this credit committee was very much influenced and controlled by Johns, in the sense that his discretion covered most of the transactions. The committee only considered investments put to it by Johns that exceeded his discretionary limit. Recommendations were then made to the directors. Evidence shows that these were simply one-line statements of recommendation.

The investment banking credit committee never met. Green described it as essentially acknowledging "... transactions which, in the majority of cases, were already consummated". He said that Johns told him it was not his function to query or analyse investment banking transactions. He said he reported to Johns, and if Johns gave him an instruction he implemented it.

The role of Mr Ziebell came under particular notice in evidence. He described his involvement in category A transactions as relating to "administration only", but he was clearly involved in implementing various "mechanisms" for the distribution to third parties of their profit entitlements arising out of category A transactions. Mr Ziebell gave evidence about "arrangements with category A where invoices would be raised as a mechanism for the distribution of the profit". He said that these mechanisms often involved "fairly lengthy exercises" to reflect Tricontinental's position in relation to the outcome of category A transactions, and that these exercises were explained to the board.

Mr Ziebell (and Mr Hunter) were also involved in the provision of substantial shareholding notices for category A shareholdings. Mr Ziebell conceded in evidence that at least some of these notices were incorrect, in that they did not refer to the interests of the third party with whom Tricontinental had made arrangements about the shareholdings. Submissions made on behalf of Ziebell
and Hunter contend that they were not aware of those interests at the time, as they had not been told by Johns.

15.451 Mr Ziebell's administrative role was said to be expanded in response to concerns raised by the auditors about documentation (see below). For his part, Mr Ziebell said that Johns maintained tight control over category A transactions, and in effect said that Johns only told him what he wanted him to know. He said that Johns "played his cards close to his chest in relation to category A investment banking transactions". He was aware that Johns sometimes gave him flippant responses to queries made by him about the transactions.

15.452 The Commission makes the following findings about the control exercised by Johns:

(i) Mr Johns conducted the investment banking activities of Tricontinental virtually single-handed. This appears to have arisen from his continuing close personal relationship with clients. It was yet another diversion from the management responsibilities of a chief executive officer.

(ii) The great bulk of transactions, by number, came within his delegated discretion. In those cases, the credit submissions were simply records made after the event, with the barest of formal details, at least in the later years. The investment banking credit committee played no meaningful role.

(iii) The board was content with Mr Johns' tight control over investment banking transactions.

(e) Approval of submissions by directors

15.453 The evidence is not entirely clear as to how the investment banking transactions which did require approval by the directors were dealt with between board meetings. The fact that there were so few of them, particularly concerning category A matters, adds to the confusion.
Mr Rawlins could not remember whether transactions for approval by directors under discretion came to directors individually, or whether they normally came up at a board meeting, when they were discussed more fully. The probability is that they were dealt with in much the same way as credit submissions for lending transactions, especially having regard to Johns' customary desire for speed. A major problem was that the credit submissions for investment banking contained even less information than the credit submissions for lending.

Both Mr Rawlins and Mr Smith said that the category A submissions did not name the client, or state the nature of the underlying arrangements. (This would appear to have been the case, at least after early 1986 - see para 15.441 above.)

The possibilities seem to be that directors were given a written credit submission in short form, and acted on them as they were (with little more than the name of the shares, and the anticipated rate of return), or were provided with a confidential covering memorandum which gave further information (as Smith seemed to suggest), or obtained further information by speaking to Johns. The evidence is not clear on these matters. When a matter was particularly urgent, approval was sought before any written submission was prepared.

The purchase of shares in Elders Resources is an example of an oral 'submission' to directors. The client, Mr Geoffrey Lord, requested Tricontinental to make the purchase and, because it was a matter of urgency, the approval of directors was sought without a written submission. Johns recalled discussing the matter with Ryan, and he also gave the details to Stott, so that he could contact other directors. There was evidence that oral approvals were obtained from Moyle, Smith and Ryan on 6, 7 and 8 January 1987 respectively. The written submission was dated 14 January 1987.
If shares purchased were those in a strong public company, they were likely to provide good security. If the shares were in a lesser company, then the directors had a vital interest in being satisfied about the financial capacity of the client with whom Tricontinental had the underlying arrangement, and the enforceability of that arrangement. From 1986 onward, credit submissions for category A transactions were of little assistance to directors if they sought to consider those matters.

The Commission makes the following findings about the approval of investment banking submissions by the directors:

(i) As shown in paras 15.432-3 above, the directors approved only a small proportion of the total number of investment banking credit submissions in the 1986-9 period (8.1%), although they did constitute 31.6% by value.

(ii) It is not clear what proportion of the submissions for category A transactions were approved by directors. It does appear that most of the submissions which the directors did approve were for category A investments (13 out of 19), but these related to only seven out of the 30 companies whose shares were the subject of category A transactions.

(iii) On any view, the directors approved a relatively small number of transactions, spread over a period of more than three years. Further, most of the investment banking transactions occurred in 1986 and 1987.

(iv) Directors appeared to recall very little about the process of approval for investment banking submissions in general, and category A transactions in particular. As discussed in the next section of this chapter, they had a stronger recollection of their consideration of the monthly reports about the progress of the investments - although even that recollection was confused on matters of detail.

(v) As also discussed in the next section, the need for confidentiality was put to the forefront as an explanation of the paucity of material in both the credit submissions and later management reports.

(vi) The criticisms of the directors' approval of credit submissions for
lending apply even more strongly to their approval of submissions for
investment banking.

(vii) In particular, there is nothing to show that directors took a close
interest, at the approval stage, in the details of the financial strength of
the client, the details, documentation, or enforceability of the
underlying arrangement, or the real worth of the 'guarantee' implicit in
the ability of Tricontinental to exercise a put option if the value of the
shares fell below their cost to Tricontinental.

(viii) Questions concerning the legality of the transactions are discussed later
in this chapter. Whilst some attention was directed to this aspect at
board meetings, there is no evidence to indicate that it was raised at the
approval stage, except, perhaps, if approval was first sought at a board
meeting.

(f) Management reports to directors

At board meetings there was discussion of the investment banking transactions
already approved, whether that approval was by Johns or directors. Discussion
was provoked by the nature of the transactions, and the form of reporting.
Directors were given a list of investment banking transactions approved since
the preceding meeting. They were also given a list of all current investments,
together with information as to the purchase price, current market value, and
the current gain or loss that resulted from the difference.

As Mr Moyle noted in evidence, the board had the full investment portfolio
reported to it each month, and it monitored the performance of the investments
on a month-by-month basis through those reports. It was in this context that
the separate lists for category A and category B share holdings came about -
the directors would then know that, for matters listed in category A, some sort
of arrangement was in place which was intended to protect Tricontinental from
losses, and, in some cases, to provide for profit sharing.
15.462 The investments were listed by reference to the names of the companies in which the shares were held. There was no written reference to the name of the 'third' party with whom there was an underlying arrangement. Johns told directors the name of the third party, and the nature of the underlying arrangement. The reason given by Johns for this procedure was the need for 'Chinese walls' within Tricontinental, to restrict the flow of confidential information.

15.463 The need for secrecy was accepted by directors without demur. They were aware of the price sensitivity of information, and the confidentiality of the arrangements. It was not appropriate for the information to be available for general distribution throughout Tricontinental. Mr Smith said that the board was entitled to the information, and was able to obtain it as required.

15.464 Mr Rawlins made the point that any prudent merchant bank had 'Chinese walls'. It was wise to ensure that confidential investment information did not necessarily go, for example, to the investment management division or the lending division, or perhaps in some cases to the corporate services division. The precaution was necessary to reduce the possibility of insider trading.

15.465 The evidence is not clear as to how widely the board report itself was distributed within Tricontinental. The mere fact that category A shares had been purchased by Tricontinental would be of some significance. Be that as it may, the names of category A clients, and the nature of their arrangements, was generally kept confidential from staff.

15.466 Directors differed from each other in their evidence about the extent to which Johns gave them the details of underlying arrangements. Mr Johns said that the category A transactions were discussed at virtually every board meeting, and that the directors were informed of all details, and the purpose of each transaction.
Mr Ziebell corroborated Mr Johns' evidence in this respect. He said that at each meeting Johns took the board through the whole list of category A arrangements on the board paper, and not merely new or altered transactions. Johns gave a short explanation of the current position in each arrangement. Mr Ziebell did not recall any complaint by the board about this form of report.

Mr Smith gave his recollection of how the investment banking schedule and any other information was brought to the notice of the board. He would turn over to that particular item on the agenda, invite Johns to make any comment about changes that had taken place since the previous presentation, whether there were new matters or deletions, and then invite board members to ask any questions they may have. He agreed that there might often be a question about a specific transaction, but he did not agree that Johns went through each existing arrangement, item by item, at every meeting.

Mr Smith said that he did not believe there was any difficulty about Johns revealing the identity of clients at the board meeting. If there was a new item on the list, Johns probably proffered information about the client before any question was asked by a director. Mr Smith said he was sure that if a question was asked, Johns responded with the answer.

Mr Ryan agreed with Mr Smith's evidence that Johns would not go through each category A item at every meeting, as some arrangements had been in place for quite some time. If there was a new item, or someone had forgotten about one, or any questions were raised, Johns would take the board through that transaction. He had no doubt that if there was a new transaction, Johns would at that time tell the board who the client was. Mr Ryan recalled that Johns would say that there was a holding cost with a margin on it, or a holding cost at about the bank bill rate. He would say that there was profit sharing of some dimension on top of that, and a put and call whereby there was an underlying guarantee that there would be no loss for Tricontinental.
Mr Moyle said he was not aware of the details of each category A arrangement, except to the extent that book values and market values, surpluses or deficits, were shown by the report. Occasionally, when the directors were seeking information, Johns would go through the report and outline the extent to which Tricontinental was protected. But apart from the financial implications of that, Mr Moyle said he was never aware of the actual arrangements in place.

Mr Carr said that obviously there was discussion at board meetings about category A transactions, but he was unable to recall the nature or extent of the discussion.

Mr Rawlins agreed that the written reports to the board did not give details of the third party, nor the form of the arrangements. The board relied upon the oral reports by Johns as to the nature of the transactions. The board was taken by Johns through the matters that were either new or changed. Directors did, from time to time, ask about individual transactions. Johns did not give detailed explanations of the role that a particular parcel of shares might have, for example in relation to a takeover bid. The information basically concerned the arrangement Tricontinental had, to protect itself from risk. Mr Rawlins said that his concern about Johns not giving the board adequate information was not directed to the holdings of category A shares.

The Commission makes the following findings about the management reports to the board:

(i) The reports to the board, and the discussions at the meetings, were the means by which directors were first informed about a significant segment of Tricontinental’s business activities.

(ii) This was in contrast to the position with lending transactions where, in the great majority of cases (by value), usually three non-executive directors had been aware of the credit proposal before approval.
(iii) Thus there was a powerful reason for adequate written and oral reporting, and discussion, of investment banking transactions at board meetings.

(iv) Another reason for regular review was the need to monitor the value of the share portfolio. In the case of category B investments, Tricontinental was directly at risk, according to the market performance of the shares. In the case of category A holdings, the shares effectively represented the security for the "loans", and were the source of some profits. There was therefore the need to monitor the potential profits, or the likely requirement for, and effectiveness of, the protective mechanisms.

(v) The reporting process underlined the very marked degree to which Mr Johns controlled Tricontinental's investment banking business, and the willingness of the directors to allow the business to be conducted in that manner.

(g) Concern about adequacy of documentation

Tricontinental's auditors were concerned about several aspects of category A transactions. These included:

- the absence of documentation, or the lack of adequate documentation;
- the close control exercised by Johns, and the exclusivity of his knowledge;
- a problem in the flow of information from Johns to the accounting department, which inhibited proper accounting for the results of transactions.

There was considerable evidence about the communications between the auditors and directors on these matters, and the response by the directors; see paras 12.26-41, 12.46-47, 12.50 and 12.63-67 above. The evidence of events differed substantially as between directors, and the evidence of some individual directors varied from one occasion to another in the course of the hearing. On
the other hand, contemporaneous notes made by one of the auditors, Mr Barry Weir, provided some relatively firm reference points.

The evidence on these issues is closely analysed in the written final submissions put to the Commission on behalf of the auditors. Counsel submit that Johns, Ziebell and Moyle acknowledged that there was a concern regarding lack of documentation for category A transactions, and that this was discussed by the audit committee and the board. They also submit that contrary evidence by Ryan, Smith, Morton and Carr should be rejected. These directors stated their belief that all category A transactions were adequately documented, the problem simply lay in the ‘flow of documentation’ from Johns to the accounting department, and this was rectified.

Counsel submit further that the following matters bear upon the adequacy of category A documentation:

(i) Following the external audit for the year ended 30 June 1987, Weir and Bray conferred with Johns and Ziebell on 11 August 1987. Weir believes that this was the first occasion on which he raised his concern about the lack of documentation.

(ii) In any event, he raised the matter when he conferred with members of the audit committee (Smith and Ryan, together with Johns and Ziebell) on 1 September 1987; see paras 12.33-40.

(iii) A letter dated 23 December 1987 was sent by Weir to the board. It was a "report to management" on the external audit for the year ended 30 June 1987. The following was said about investment banking:

"In vouching calculations of income earned by this division and verifying a receivable of $2.8 million in respect of that income we found that documentation was lacking. Our enquiries revealed that staff delegated the responsibility of accounting for income were unaware of the basis for some entries, resulting in an overstatement of the receivable amount, although not by a material figure.

Following discussions with the Group Managing Director who directly controls the operations of this division, we were to be provided with schedules supporting the income and receivables
reported by the division. We have not yet received these schedules.
We believe that the operations of all divisions of the group should be fully documented, and that the sensitivity of the information or the nature of the operation should not be a reason for inadequate documentation. Inadequate documentation exposes the group to the risk of being unable to generate or recreate information lost through the absence of any staff members.

Recommendation
We recommend that steps be taken to create complete files for all investment banking transactions including copies of all agreements, income arrangements and other relevant documentation.

(iv) The letter was discussed at the board meeting held on 27 January 1988.
The relevant minute reads:

"The managing director led the Board in a discussion on the 1987 audit letter by Peat Marwick Hungerfords as set out in agenda pages 48 to 58 of the Board papers. The Board noted the audit partner's comment. However, agreed in regard to investment banking, to continue the current status of operations."

(v) In evidence Mr Ziebell said that the reference to continuing the "current status of operations" meant that Johns had persuaded the board to allow him to continue his existing mode of operation.

(vi) A meeting of the audit committee in February 1988 dealt with the auditors' letter; see paras 12.47-48. According to Mr Ryan, the accounting error was not due to a lack of documentation, but the failure of Johns to pass on the necessary information to the accounting department. It was agreed that in future Johns would share with Ziebell the information necessary for accounting procedures. Mr Smith's evidence was to similar effect - there had been "a hiccup somewhere in the system". He had no recollection of any inadequacy in the documentation.

(vii) Weir's notes of the audit committee meeting in February 1988 record that the management letter was discussed, and the directors present (Ryan, Morton, Johns and Ziebell) recognized that investment banking
controls were lacking "particularly in the area of documentation".

(viii) The next internal audit report, dated 20 April 1988 (see para 12.51), stated that "the concern reported in our external report to management of 23 December 1987, regarding the completeness of documentation in respect of individual transactions, remains". The notes by Weir show that this aspect of the report was discussed at the audit committee meeting held on 24 June 1988.

(ix) Weir's notes also record that, at the audit committee meeting held on 23 August 1988, he raised the question of documentation again, and noted "documentation generally improved"; see paras 12.64-68.

(x) Despite this general improvement, the December 1988 internal report noted:

"Our continuing concern as to the lack of completeness of documentation for individual transactions regardless of the sensitivity of the information or the nature of the operation has to some extent been remedied. However, the remaining inadequate documentation exposes the group to the risk of becoming unable to generate or recreate information lost through the absence of any staff members.

For example, Bond International Gold Inc. put option agreement was only from yourself and any extraction or copying was not possible by the audit staff.

We believe it to be in the best interest of the board that Bruce Ziebell's involvement be further extended."

The Commission notes that, at the end of all this, Johns remained unrepentant.

By letter dated 6 December 1988 to Weir, he responded to the internal audit report on investment banking in the following terms:

"Many thanks for your letter of 2nd December, 1988 and for enclosing the internal audit review for Investment Banking Division.

I have explained on a number of occasions to yourself and the Board of Tricontinental that it is difficult to complete documentation to your satisfaction for a number of these transactions, for obvious reasons.

In relation to the put option for Bond International Gold, this was provided to Mr Michael Bray however, for obvious reasons is not available to be photocopied."
15.480 The Commission makes the following findings about the adequacy of documentation:

(i) It is satisfied that, in a number of category A transactions, written records of the ancillary agreements did not exist. Later this led to losses, when third parties denied the existence of the arrangements.

(ii) Where documents did exist, Mr Johns did his best to keep them to himself. As a result of pressure from the auditors, more information was made available to Mr Ziebell so that he could at least become aware of the financial results of transactions.

(iii) The auditors had a well based fear of the consequences of Johns keeping information to himself. The question arose - what would happen if he were hit by the proverbial tram?

(iv) The directors exhibited a reluctance to require Mr Johns to change his ways. At the meeting on 27 January 1988, they agreed "to continue the current status of operations".

(v) The Commission notes that the evidence by directors diverges from that of Mr Weir on a number of points concerning the discussions between them. No reason has emerged to cast doubt upon the authenticity and correctness of Mr Weir's contemporaneous notes, and where they differ from the more recent recollections of directors, the notes are to be preferred.

(vi) The issues concerning documentation show once more the extent of the directors' dependence upon Mr Johns in investment banking matters, and the extent of their willingness to leave such matters in his hands.

A question necessarily arises as to how much the directors really wanted to know about the details of investment banking transactions. This is material to the issue considered in the next section.

15.482 (h) Concern about legality of transactions

There was evidence of concern by the auditors that the lack of documentation could be construed as an attempt to conceal illegal conduct, such as the
warehousing of shares, or insider trading. This evidence has already been referred to in chapter 12 of this report - see particularly paras 12.28-38, 12.63-67, 12.87.

This was another area in which evidence differed as to the communications that passed between the auditors and directors and, indeed, as to what discussions took place amongst the directors on the question of legality.

Once again, the evidence has been closely analysed in the final submissions made on behalf of the auditors. It is submitted that Moyle and Ziebell agree that at an audit committee meeting (probably the one held on 23 August 1988), Weir raised issues of the possibility of warehousing, insider trading or other improper activity arising from category A transactions. It is further submitted that evidence to the contrary by other directors is in error, and at odds with the contemporaneous written records made by Weir.

Evidence upon which submissions for the auditors place particular reliance includes the following:

(i) Mr Ziebell had concerns about warehousing, at least in respect of one transaction, as early as 1987. As he put it in his evidence, when he was "cleaning up the balance of Hooker" he suspected warehousing in respect of that transaction. The transaction was completed during the financial year ended 30 June 1987. Ziebell explained "the mechanics of what had occurred" to the board, but did not express his thoughts about possible illegality.

(ii) Mr Ziebell prepared a handwritten note on 22 August 1988. It stated, in part, "Matters that Barry Weir will raise at tomorrow's Audit meeting ... (c) with Investment Banking concerned about warehousing and insider trading". Mr Ziebell said it was "an idea of the sorts of things that Barry was going to raise at that meeting".

(iii) Mr Ziebell said that, at the audit committee meeting on 23 August 1988, Weir did raise a concern about insider trading in relation to
Elders Resources shares, and asked directors present whether they had
"thought about that as a possibility". He did not recall whether Weir
also referred to warehousing.

(iv) Mr Moyle said that, at that meeting, Weir raised the lack of
documentation, in the context of possible allegations of warehousing or
insider trading. Moyle stated:

"I've said several times that I can recall an occasion at about this time on which I put directly to Mr Weir this question of insider trading and warehousing and received a statement that there was nothing in his view that was untoward."

(v) Mr Moyle also said, of the meeting on 23 August 1988:

"I was afraid, when I saw the agenda [referring to Ziebell's note of 22 August], which had on it insider trading and warehousing, that Mr Weir was suggesting that, in fact, these arrangements constituted insider trading and warehousing, and I wanted immediately to be reassured that that was not what he was suggesting, and having raised that with him I was told that there was nothing untoward, that was not what he was suggesting, it was an inference that might be drawn from the lack of documentation, as you put it, but that the documentation was generally improving."

Mr Moyle added that Ziebell's agenda note had "raised his hackles",
and led to him raising the question with Weir.

(vi) Mr Weir's first concern at the possibility of warehousing occurred
during the course of the 1987 external audit in relation to the
Hooker/Herscu transaction. He could not recall specifically mentioning
the word "warehousing" at any audit committee meeting before August
1988. He did refer from time to time to the need for documentation
because of "the nature of the deals", meaning deals that were subject to
put and call options.

(vii) Mr Weir had no independent recollection of the discussion at the
meeting on 23 August 1988, but his notes (made either at the meeting
or shortly after) led him to believe that he used Elders Resources as an
example of a transaction where it could be alleged that Tricontinental
was involved in either warehousing or insider trading.
Counsel for the auditors submit that, in the circumstances, the Commission should place no reliance on evidence by Smith, Ryan and Morton to the effect that they had no recollection that warehousing or insider trading were discussed at the audit committee meeting on 23 August 1988. No weight should be placed upon Smith's denial of Moyle's evidence about what was said at the meeting.

As to board meetings generally, counsel for the auditors rely on evidence by Moyle about discussions concerning the legality of category A transactions. He said:

"The questions of legality of these transactions was raised frequently by me at Board level, not only in relation to category A investments, but to other types of transactions, and I was regularly assured that no illegality would be entertained by Tricontinental ..."

Counsel for the auditors focus a great deal of attention upon evidence by Mr Rawlins, who said, in effect, that he had had no concerns about the nature of category A transactions. They emphasise that his stockbroking background qualified him to be conscious of warehousing and insider trading problems, and to recognize the signs. They argue that his stated lack of concern about the transactions was not credible.

As noted earlier, Mr Rawlins gave tax planning, balance sheet purposes, anonymity, flexibility and elimination of administrative hassles as proper reasons why clients would enter into category A arrangements with Tricontinental. Counsel submit that, if Rawlins considered that clients were seeking anonymity, the possibility of warehousing must have crossed his mind. Mr Rawlins did say that questions were asked at board meetings from time to time concerning the legality of tax planning arrangements. Counsel submit that this implies that the board discussed the reasons why clients sought category A facilities, and sought assurances that the reasons were proper.
Detailed written final submissions have also been made on behalf of the directors. They traverse much of the same ground, but the submissions are designed to demonstrate that the auditors did not bring anything of particular concern to the attention of the directors as to the legality of the category A transactions. Thus there is emphasis upon the gap of more than twelve months between Weir's first concern about possible warehousing, and discussion at the audit committee meeting in August 1988. And there was no recollection by him of concern about insider trading before August 1988.

The audit committee meeting of 23 August 1988 is examined, this time with emphasis upon the significance of the evidence by Smith, Ryan and Morton, to the effect that they had no recollection of any reference to warehousing or insider trading, but that they would have, if the words had been used.

Mr Ziebell's evidence is dealt with on the basis that Weir raised the possibility of insider trading in relation only to a single transaction (Elders Resources), using words to the effect of "Have you thought about that as a possibility?" Weir's comments were "very general, very open". Johns apparently dismissed the query then and there. Ziebell recalled no mention of warehousing. As with Smith and Ryan, he believed he would recall it if it had been mentioned because "it has a bad ring to it".

Counsel for the directors submit that Moyle asked Weir whether he was suggesting that the investment banking arrangements did constitute insider trading or warehousing. Weir responded that he was not suggesting that there was in fact anything untoward but merely that it was an inference which might be drawn. Weir's assurance that he was not aware of anything untoward was unequivocal. Under cross-examination, Mr Weir conceded that he was concerned only about possibilities and not about actualities. He never had positive knowledge that warehousing or insider trading had occurred. He believes he used Elders "as an example of where a threat lay that a transaction could be interpreted as either warehousing [or] insider trading".
15.494 A supplementary submission on behalf of the directors, in reply to the submission on behalf of the auditors, spells out the following summary of the directors' contentions:

(i) The board did not know of any illegal activity in any category A transaction.

(ii) It was aware of the commercial risks.

(iii) It was also aware that illegality was a possibility, as was Weir.

(iv) With this awareness, the board relied upon assurances by Johns that legality was appropriately checked.

(v) The board also relied upon continual monitoring by the auditors, in the expectation that any actual illegality would be reported if detected.

(vi) The divergence between Weir's contemporaneous notes and the beliefs of Smith, Ryan and Morton suggests that the manner in which Weir's comments were delivered was not such as to raise concern. It is significant that Weir spoke only in terms of possibility, and did not seek to speak to directors in the absence of Johns.

15.495 It is also submitted on behalf of the directors that the board took reasonable and appropriate steps in response to all of the matters raised by the auditors concerning documentation, control and legality:

(i) Documentation improved by the second half of 1988.

(ii) Mr Ziebell was given greater involvement, and could deal with accounting aspects effectively.

(iii) The board accepted general assurances from Johns (as it was properly entitled to do) that appropriate legal advice was taken.

(iv) The board liaised with the auditors through the audit committee. At no stage did Weir actually say that there was illegality involved.

(v) At no relevant time did anyone distrust Johns, or have grounds to do so.

15.496 The Commission makes the following findings about the concerns and enquiries of directors regarding the legality of investment banking transactions:
(i) There are conflicting accounts of what was discussed at the audit committee meeting on 23 August 1988.

(ii) On the balance of probabilities, the Commission accepts that Mr Weir raised both insider trading and warehousing as matters of potential concern. The evidence of both Mr Weir and Mr Moyle is accepted on this point, fortified by that of Mr Ziebell, even though he does not recall whether warehousing in particular was discussed.

(iii) The Commission does not accept the proposition that because Mr Smith, Mr Ryan and Mr Morton have no recollection of reference to insider trading or warehousing (and also Mr Ziebell, as to warehousing), there could not have been any reference.

(iv) On the other hand, the Commission thinks it likely that Mr Weir expressed his concern in very muted terms, referring to possible perceptions rather than existing situations, so much so that, apart from Mr Moyle (whose interest was particularly aroused by the issue), the others had no particular reason to recall the conversation.

(v) The Commission finds the lack of curiosity by Mr Rawlins quite strange. His background was one to put him on alert as to the possible implications of Tricontinental's investment banking, particularly in the category A transactions. It would be one thing for him to say that he had given the matter some thought, and received assurances or was otherwise satisfied that there was no risk of breaches of the Companies Code provisions about insider trading and warehousing. To say, in effect, that the possibility never caused him any concern, seems disingenuous.

(vi) There appears to be corroboration that Mr Moyle sought assurances from time to time as to the 'legality' of transactions. This may have indicated nothing more than concern about enforceable documentation for the arrangements in category A transactions, or the validity of tax planning arrangements, as mentioned by Mr Rawlins, but it seems
probable that the enquiries extended to the requirements of the Companies Code.

(vii) If Mr Moyle was seeking assurances that there was no insider trading or warehousing, then no doubt all the directors would have understood the thrust of his questioning. This apparent need for comfortable assurance could explain an apparent lack of enthusiasm, by Mr Moyle and the other directors, to learn more about the precise details of each transaction.

15.497 Some of the category A investment banking transactions, and transactions which had elements analogous to category A arrangements, are described briefly in the next section.

(i) Particular transactions examined

15.498 The investment banking transactions examined in public by the Commission are summarized in transaction reports 14-19, in volume 3 of this report. Ten further investment banking transactions were reviewed privately by the Commission. These are referred to in transaction report 20. A number of the latter transactions raised questions of propriety, particularly suspected warehousing, which the Commission has not had the opportunity to investigate further. It is possible that some of those matters may be investigated elsewhere, after this report is delivered.

Long Corporation Limited shares

15.499 Fuller details of this matter are set out in transaction report 14. Long Corporation Limited (‘Long Corp’) was a residential property developer. In 1986 it became a takeover target, and Tricontinental was appointed to assist in the defence. As part of this, Johns introduced Jack Chia (Australia) Limited (‘JCAL’) to Long Corp as an alternative bidder. Then followed a series of transactions in which not only JCAL, but also ‘friends of Tricontinental’ acquired shares in Long Corp. These included Camsan Pty Limited (‘Camsan’), a private investment company associated with Mr Peter Sanders.
Acquisition of Long Corp shares by Camsan was financed by Tricontinental, which then retained the shares, together with signed blank transfers, as 'security'.

15.500 JCAL succeeded in its share-swap offer for Long Corp, and at Johns' direction, the Long Corp shares held by Camsan were, together with shares held by others, transferred to Jacy Investments Australia Limited ('Jacy'), a company associated with JCAL. Tricontinental's facility to Camsan was repaid from funds held in a money market account for JCAL. The Camsan transaction was a variation of the category A transactions in which Tricontinental held shares on behalf of a client. Here, Tricontinental financed an acquisition of shares by one client, and retained the ability to direct those shares to another client.

15.501 A number of inter-related facilities made available by Tricontinental to Long Corp and JCAL were under the control of Johns. If the transactions were regarded as loans for shares, then the lending guidelines were disregarded. If they were regarded as investment banking transactions, then there were no guidelines of relevance. Transaction report 14 shows that Johns made all the decisions, and members of staff to whom he directed memoranda merely carried out his instructions in those matters.

15.502 Other directors had little to do with the transactions, except that the initial facility of $2.5m to JCAL was approved by Ryan, and an extension of the facility of $865,000 to Camsan was approved by Ryan and Moyle. Having regard to Johns' discretion to $3m at the time, approval by directors other than Johns was not necessary, unless these facilities, and possibly others, were aggregated under the name of either Long Corp or JCAL.

15.503 Transaction report 14 tells the story of the Long Corp share acquisitions to some extent, but the lack of adequate documentation for a series of inter-related facilities makes it difficult to engage in any useful analysis. That, in
itself, is a major point of criticism. The transactions relating to the takeover of Long Corp have the hallmarks of warehousing arrangements, but the investigation trail is probably too cold now. However, as noted in transaction report 14, another aspect of these matters has been raised for further consideration in confidential volume 4 of this report.

Command Petroleum N.L. shares

Fuller details of this matter are set out in transaction report 15. Command Petroleum N.L. ('Command') was the subject of a partial takeover bid by Rocado Investment and Finance Limited ('RIFL'). RIFL was an investment company of Mr Stephen Matthews and Mr Peter Hunt. It held a 19.89% interest in Command. In February 1986 the bid changed from a share swap to a cash offer. Johns agreed that Tricontinental would fund the offer. That was outside the limits of his discretion. Johns was a director of RIFL at the time. In addition, Tricontinental lent $1,386,247 to Camsan Pty Limited ('Camsan'), which purchased 9.8% of the shares in Command from Perth stockbrokers, Benny Partners through their nominee company, Alexisse Nominees Pty Limited ('Alexisse'). Tricontinental then held the scrip as security, but later it was delivered back to Alexisse. In response to s.261 notices served by Command, Sanders stated that neither Camsan nor Sanders had any relevant interest in Command. Sanders was concerned that he may be regarded as an 'associate' of RIFL, and sought repayment of the Tricontinental facility by someone other than Camsan. Eventually Tricontinental was paid out by funds from RIFL, and RIFL acquired the shares from Alexisse.

The principal points which emerge in this matter are that:

- Mr Johns was prepared to give a commitment beyond his authority to RIFL, a company of which he was a director.
- Mr Johns had told Matthews, of RIFL, that he would make arrangements for Sanders to become the holder of the Alexisse parcel of Command shares. Johns was prepared to involve Tricontinental in a warehousing type of arrangement which could well have led to
prosecutions if it had not been dismantled. When the import of the s261 notices hit home, Sanders wanted to unwind the arrangement.

• A facility was granted to Camsan, and repeatedly extended, under Johns' discretion, even though the value of the shares held as security had fallen as low as .39 times cover, and repayment of the loan was to come from a third party which was not contractually bound to repay.

This transaction is another instance of the use of Camsan as a vehicle to place shares in hands that were friendly to Tricontinental. In this case the ultimate client was not Camsan, but RIFL.

**Bond group matters**

Fuller details of these matters are set out in transaction reports 16-18. Tricontinental's dealings in the shares of Windsor Resources NL, Mid-East Minerals Limited, and Metals Exploration Limited, all at the behest of its client Dallhold Investments Pty Limited ('Dallhold'), are classic cases of category A transactions.

**Windsor Resources NL ('Windsor')**

In May 1985 Tricontinental purchased 1 million shares in Windsor, at a cost of $483,840. In January 1986 those shares were sold to Dallhold for $750,000. Between May and September 1986, Tricontinental purchased a further 828,500 Windsor shares pursuant to an investment banking facility approved by Johns under his discretion. In December 1986, a further 887,600 Windsor shares were purchased under a similar arrangement, again approved by Johns. A question was raised as to whether this purchase involved insider trading. In January 1987, North Kalgurli Mines Limited made an unconditional cash takeover offer for Windsor, which was accepted by Tricontinental.

Documents examined by the Commission show that there was a profit sharing arrangement between Tricontinental and Dallhold for the Windsor shares. Attention then focused upon various other arrangements concerning invoices.
for 'services' by Dallhold to Tricontinental, which were simply a contrived means of seeking to give Tricontinental an income tax deduction for the payment to Dallhold of its share of the profit on the sale of the Windsor shares.

15.510 The evidence shows that all significant events occurred at the instigation of Johns, but some credit submissions were approved by other directors. Ziebell was involved in the arrangements for the accounting of profits. Submissions by his counsel turned upon whether he instigated those arrangements, or was carrying out directions given by Johns.

15.511 The Commission finds that the present evidence is inconclusive on several matters. Time constraints prevented the Commission from investigating fully all aspects of the facility. However, as noted in transaction report 16, the various dealings have an air of contrivance about them which could warrant further investigation by the Australian Securities Commission. The amounts involved, and the possibly fraudulent nature of the activities, are sufficient to justify such a course.

**Mid-East Minerals Limited ('Mid-East')**

15.512 In early May 1986 Mid-East was 58% owned by a subsidiary of Dallhold. Mr Robert Pearce, the managing director of Dallhold, told Johns that Dallhold intended to make a Part A bid for 100% of Mid-East. It was agreed between Johns and Pearce that Tricontinental would purchase shares in Mid-East. According to a file note dated 6 May 1986 by Johns, the agreement was on the basis that Dallhold would acquire the shares held by Tricontinental for principal cost, holding cost (20%), and 50% profit from sale.

15.513 On 9 May 1986, Johns exercised his discretion and approved an investment banking facility of up to $1m for Tricontinental to purchase Mid-East shares. The facility was increased in January 1987 to $3m, and by March 1987, Tricontinental had purchased 2,860,923 shares. Pearce gave evidence that an
arrangement existed that Tricontinental would, if requested by Dallhold, purchase shares in Mid-East to avoid any apprehended downward effect on market price.

15.514 On 30 September 1988 Tricontinental sold all its Mid-East shares for $1,037,023. This was a loss to Tricontinental, after taking into account purchase and holding costs. Tricontinental was paid $1,463,000 by Dallhold. This included a component to indemnify Tricontinental for its loss, pursuant to the category A arrangement between them.

15.515 Issues which arise include whether Tricontinental and Dallhold were "associates" in the bid for Mid-East shares, and whether purchases approved by Johns and made by Tricontinental created a false or misleading market. The Commission has decided to draw these matters, and other aspects of the transaction report, to the attention of the Australian Securities Commission.

Metals Exploration Limited ("Metals Ex")

15.516 The purchase of shares in Metals Ex by Tricontinental was another transaction that arose from an arrangement between Johns and Pearce. In August 1986 Metals Ex was owned by Dallhold (58.53%) and Mid-East (42.22%). In late 1986 Dallhold was unsuccessful in takeover bids for Mid-East and Metals Ex. In about October 1986 Johns and Pearce agreed that Tricontinental would, if requested by Dallhold, purchase shares in Metals Ex to avoid any apprehended downward effect on the market price. By mid-June 1987, Tricontinental held over 2 million shares in Metals Ex.

15.517 On 30 June 1987 Tricontinental sold all the shares, and on 1 July 1987 repurchased the same number. This enabled a profit to be realized in the year to 30 June 1987. The profit was shared between Tricontinental and Dallhold. The shares were sold again in late 1988, when Tricontinental accepted an offer by Mid-East. The profit was again shared between Tricontinental and Dallhold. The evidence shows that this investment banking facility was under
the control and discretion of Johns. Other directors approved an extension of the facility to 31 August 1988.

15.518 Clearly, Johns had a very close working relationship with Pearce. Once again, issues which arise include whether Tricontinental and Dallhold were "associates" in the purchase of shares, and whether purchases approved by Johns and made by Tricontinental created a false or misleading market. Further investigations by the ASC would be necessary to enable any positive findings to be made about those issues.

Messara group matters

15.519 Fuller details of these matters are set out in transaction report 19. Investments were made by Tricontinental in the shares of Southland Mining Limited, and Australian Racing And Breeding Stables Limited.

Southland Mining Limited ("Southland")

15.520 Southland was a publicly listed company involved in mining exploration and development. Mr John Messara was chairman. In 1986 Southland was taken over by Devex Limited ("Devex"), another mining company of which Messara was chairman.

15.521 In February 1985 Tricontinental approved a $2m facility to J M Messara Financial Services Pty Limited ("JMM") for the purchase of 9 million shares in Southland. The shares were purchased and held in Tricontinental's name. 'Security' was a put option and repurchase agreement between Tricontinental and Messara and/or JMM. (This is the facility referred to in para 15.441 above, to illustrate the fuller type of format for category A submissions.)

15.522 By December 1985, this facility and shareholding had increased from 11.15% to 19.54% of Southland. In October 1985 Devex started to take over Southland. In January 1986, during the takeover period, Mr Terence Caplice (a business associate of Messara) told Johns that his entity, HVRN Nominees
Pty Limited (‘HVRN’), was the beneficial owner of Tricontinental’s parcel of Southland shares. A credit submission dated 2 February 1986 was compiled, noting HVRN as the borrower of $4.02m. This facility was used to pay out the existing facility granted to JMM. After that, Tricontinental treated HVRN on the same terms and conditions as previously applied to JMM. On 3 October 1986 HVRN paid out Tricontinental, and the shares were transferred to it.

Once again, Johns had extensive involvement in the transactions. The original facility granted to JMM in 1985 was recommended by the investment banking credit committee (which included Johns) and approved by Mr Redenbach, who was then the managing director. In 1986 Johns was managing director, and together with Ryan approved the facility granted to HVRN.

Significant issues to emerge from the transaction include the alleged warehousing of the Southland share parcel by Tricontinental on behalf of Messara/JMM/HVRN. This issue and others are discussed in detail in transaction report 19. The Commission’s findings are set out at paras 80-81 of that report.

Australian Racing And Breeding Stables Limited (‘ARABS’)

ARABS was the first publicly listed company in Australia formed for the purpose of breeding and racing thoroughbred horses. Messara was a director and major shareholder. Between March 1986 and December 1988 Tricontinental purchased shares in ARABS at a cost of more than $14m. The first transaction was a facility for $1.35m, approved by Johns in March 1986. This is the facility used in para 15.441 above to illustrate the briefer format for category A submissions.

A written submission to the Commission on behalf of Messara disputes that there was a category A arrangement (see paras 124-125 of transaction report
19. Counsel assisting contend that this submission should be rejected (see para 126 of the transaction report).

15.527 The anticipated net return of "not less than 25%" had grown to a book profit of 40.7% by 17 April 1986. The history of events after that is set out in detail in transaction report 19, from para 83 onward. In May 1986 ARABS and Mr Robert Sangster announced a joint venture which amalgamated their respective thoroughbred breeding interests in Australia. The ARABS share price went from $1.35 in March 1986 to $3.50 in July 1986. On 27 June 1986 Tricontinental took the profit by selling 1 million ARABS shares for $3.2m, then bought them back again for the same price on 30 June 1986. Clearly Tricontinental was anxious to crystallise the profit before the end of the financial year, and split it with Messara. A half share amounted to $865,000.

15.528 Between June 1986 and December 1988, the original facility of $1.35m was expanded in stages to $14.07m, as Tricontinental purchased further parcels of ARABS shares. On the limited evidence available to the Commission, it appears that after the disposal on 27 June 1986, Tricontinental’s continued investment was at its own risk. As at January 1992 the anticipated loss (including holding costs) was $19.75m.

15.529 Mr Johns was heavily involved at all stages of the relationship. Other directors approved the increases to the initial facility. As shown by the detailed discussion in transaction report 19, a number of complex issues arose out of the ARABS transactions. One issue was whether there was an attempt by Tricontinental to disguise the sharing of profit with Messara. HVRN became involved in that issue. The sale and repurchase of the shares attracted the attention of the NCSC, and the distribution of the profit attracted the attention of the Australian Taxation Office. There was a related issue as to the role of Mr Ziebell in Tricontinental’s accounting treatment of the profit. His counsel submit that he did no more than carry out Johns’ instructions.
The Commission has concluded that in the absence of evidence from Mr Johns and Mr Messara, it is not possible to identify the true nature of the transaction. Further, given the enquiries by the NCSC in 1986 and ATO in 1987, there is little point now in revisiting the circumstances of the profit distribution in 1986.

**Hooker Corporation Limited ('Hooker')**

Mr Johns gave evidence about an approach from Mr George Herscu, to ascertain whether Tricontinental would purchase Hooker shares, if Herscu agreed to make good any loss on the sale of the shares. Mr Johns said Herscu gave as the reason for the request that he was looking for a friendly shareholder. The transaction was approved by the board. Mr Johns was asked whether he recalled explaining to the board that Herscu was looking for a friendly shareholder. He replied "I can't precisely recall that. I think I did, but I can't precisely recall the exact wording I told the board."

Mr Ziebell said that he was aware that, in certain transactions, Tricontinental held shares on behalf of clients. He had a concern about the legality of the acquisition of shares in Hooker:

"We bought shares in Hooker at about the same time before or after - I never worked out the exact timings - the client was also making a takeover bid for Hooker."

He said that he did not know when his concern arose, but probably later when working out how to finalise the transaction - the return to Tricontinental, and the profit to Herscu upon the sale of the shares. He did not express his concern to other members of the board - see para 15.485(i) above.

**Elders Resources Limited ('Elders Resources')**

This matter was not examined in detail in the Commission's public hearing, but it was one of the transactions reviewed privately, as discussed in transaction report 20. However it was referred to in the public hearing, as an example of those transactions in which directors gave their approval before a credit submission had been prepared.
In evidence, Mr Johns said that Tricontinental’s client, Mr Geoffrey Lord, wanted Tricontinental to acquire Elders Resources shares urgently on his behalf. The submission was for a $16.6m facility, and approval by directors was sought before a written credit submission was prepared - see para 15.457 above. When the submission was prepared, it comprised no more than a face sheet, with Elders named as the ‘client’, together with a one-line recommendation page. The transaction was listed as a category A holding because there was an arrangement for profit-sharing, and for reimbursement of holding costs. Mr Johns said that most investment banking credit submissions were brief, particularly in relation to shares purchased under his discretion, and the Elders Resources submission would have been typical.

Mr Johns said that he spoke to Ryan, who understood the profit sharing arrangements when he was asked to approve the submission, and the matter was also discussed at various board meetings after that date in relation to profitability.

In addition to what has been said in evidence about the need for confidentiality, Mr Johns gave another reason why the name of the company in which the shares were held was inserted as the ‘client’ in category A credit submissions. Tricontinental had a system on its computer by which all limits and exposures were recorded. If shares were purchased in a company, the transaction would be recorded as an exposure against that company. (There was no discussion of whether the computer was capable of being programmed to record an exposure, yet still record the name of the true client.)

The Elders Resources transaction has been considered earlier, in the context of discussions between Weir and members of the audit committee on 23 August 1988 - see paras 15.492-493 above.
(j) Performance by directors

The Commission accepts submissions by counsel assisting that the board's performance was inadequate, in that it failed as follows:

(i) To set or implement any prudent policies for category A investment banking.

(ii) To record the nature of the category A transactions in a way that ensured information was not solely dependent on Mr Johns.

(iii) To conduct a proper review of investment banking transactions, so as to understand fully the financial and legal implications, in order to protect the legality and security of Tricontinental's position.

(iv) To implement an appropriate system of controls for category A transactions, which would take account of sensitive information, yet not permit all knowledge to be restricted to one person.

(v) To understand fully the nature of the security taken by Tricontinental for category A facilities.

(vi) To appreciate fully the potential risk of loss to Tricontinental, from having to enforce its rights under arrangements for category A facilities where those arrangements were undocumented, or poorly documented.

(vii) To appreciate fully the potential risk of loss to Tricontinental, in the event that the put option would not be honoured by the other party, if it had insufficient assets to indemnify Tricontinental for any shortfall in the value of the shares.

The Commission makes the following findings about the conduct of Tricontinental's investment banking business, and the performance by the directors in particular:

(i) Investment banking was a significant part of Tricontinental's business.

(ii) It was conducted almost entirely by Mr Johns. There is no evidence to suggest that he had any particular expertise to do so, or that he sought any independent advice. Managers and staff did what they were asked, when they were asked, and were generally confined to mechanical tasks.

(iii) The operating guidelines provided for a system of delegated discretions for the approval of investment banking facilities. They did little else.
In particular, there was no guidance as to the types of share investments Tricontinental could make, or the nature of any arrangements with clients. The guidelines were entirely silent as to the class of facility which became known as category A.

(iv) The great majority of investment banking transactions were approved by Mr Johns under his delegated discretion, from March 1986. Most of the investment transactions approved by directors were category A facilities, but it seems likely that Mr Johns was still solely responsible for the approval of the majority of category A transactions.

(v) Criticisms made of directors concerning their approval of credit submissions for lending transactions apply even more strongly in the case of approvals for category A investment banking transactions. Information given and considered as to the financial capacity of the real clients was minimal.

(vi) Category A transactions were, in effect, loans to clients, made subject to arrangements which were intended to secure for Tricontinental good profits, and an indemnity against loss. An important factor for many clients was anonymity, through the acquisition and holding of shares in friendly hands.

(vii) These transactions give rise to deep suspicions of warehousing, some insider trading, and failure to disclose relevant interests in substantial shareholdings.

(viii) A great deal of evidence was directed towards the awareness of directors, senior management and auditors, as to these possibilities.

(ix) In a number of matters, it has not been possible for the Commission to reach firm conclusions as to the nature of transactions, or the knowledge - or possibilities for knowledge - of parties about those transactions.

(x) What does emerge, beyond doubt, is the willingness of directors to permit Tricontinental to engage in category A transactions, to permit Mr Johns to run that aspect of Tricontinental's business virtually single-handed, to accept his assurances as to legality, and not to press too deeply as to the details.
H. Liability of Directors

15.540 Having regard to the circumstances examined in this chapter, and elsewhere in this report, the Commission finds that all directors of Tricontinental must take corporate responsibility for the failure of Tricontinental, with Mr Johns bearing the primary responsibility, and Mr Moyle bearing the greatest share of responsibility amongst the other directors.

15.541 The legal duties of directors are discussed in detail in chapter 19. In particular, paras 19.16-17 and 19.33-92 discuss the nature and content of the duty to exercise a reasonable degree of care and diligence, imposed by s229(2) of the Companies (Victoria) Code 1981. The serious difficulties of establishing breaches of s229(2), on the criminal standard of proof beyond reasonable doubt, are discussed in paragraphs 13.146-148 and 19.127-140.

15.542 The transaction reports in volume 3 of this report examine the acts and omissions of directors in the conduct of specific lending and investment banking transactions. Conclusions are expressed, where appropriate, as to whether or not particular conduct was likely to have been in breach of s229(2) of the Code, or some other legal duty. Subject to the further investigation or consideration of the investment banking transactions referred to above, and except for other matters relating to Mr Johns that are referred to in the confidential fourth volume of this report, no proceedings should be taken against any of the directors under s229, or otherwise. The reasons for this are summarised in chapter 23.
DIRECTORS' APPROVAL OF LENDING FACILITIES

Transaction reports 1-13, in volume 3 of this report, comprise summaries of the lending facilities examined in detail by the Commission in public hearings. Set out below are summaries of the approvals given by Tricontinental directors for those facilities. They include new and increased lending facilities, but not any extensions that may subsequently have been granted.

<table>
<thead>
<tr>
<th>Transaction report number (Volume 3)</th>
<th>Company</th>
<th>Facility Amount</th>
<th>Directors Approving</th>
<th>Approval Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Atoll Corporation Pty Limited</td>
<td>$ 13.3m</td>
<td>Ryan</td>
<td>05.10.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smith</td>
<td>05.10.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>05.10.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>[Noted that Carr and Rawlins not available]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Quatro Limited</td>
<td>$ 15m</td>
<td>Moyle</td>
<td>24.02.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ryan</td>
<td>undated</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>18.02.1987</td>
<td></td>
</tr>
<tr>
<td>2. Quatro Limited</td>
<td>$ 20m</td>
<td>Carr</td>
<td>17.09.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ryan</td>
<td>undated</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smith</td>
<td>16.09.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>14.09.1987</td>
<td></td>
</tr>
<tr>
<td>2. Quatro Limited</td>
<td>$ 25m</td>
<td>Carr</td>
<td>06.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Morton</td>
<td>06.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Moyle</td>
<td>07.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ryan</td>
<td>undated</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smith</td>
<td>07.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>05.03.1989</td>
<td></td>
</tr>
<tr>
<td>Transaction report number (Volume 3)</td>
<td>Company</td>
<td>Facility Amount</td>
<td>Directors Approving</td>
<td>Approval Date</td>
</tr>
<tr>
<td>--------------------------------------</td>
<td>------------------------------</td>
<td>-----------------</td>
<td>---------------------</td>
<td>---------------</td>
</tr>
<tr>
<td>2</td>
<td>Pro-image Limited $ 20m</td>
<td>Carr</td>
<td>29.09.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Morton</td>
<td>29.09.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>28.09.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>[Noted that Ryan and Smith not available]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Disctronics Australia $ 33m Limited</td>
<td>Carr</td>
<td>27.04.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ryan</td>
<td>24.04.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smith</td>
<td>28.04.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>22.04.1987</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Tibham Pty Limited $ 65m</td>
<td>Carr</td>
<td>03.11.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ryan</td>
<td>02.11.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smith</td>
<td>03.11.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>02.11.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>[Johns’ approval confirmed 21.11.1988]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Mainsel Investments $ 31m</td>
<td>Carr</td>
<td>27.04.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pty Limited</td>
<td>Ryan</td>
<td>undated</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smith</td>
<td>28.04.1987</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>23.04.1987</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Mainsel Investments $ 11m</td>
<td>Carr</td>
<td>08.06.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pty Limited</td>
<td>Moyle</td>
<td>10.06.1988</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ryan</td>
<td>09.06.1988</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Mainsel Investments $ 17.9m</td>
<td>Carr</td>
<td>22.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pty Limited</td>
<td>Morton</td>
<td>21.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Moyle</td>
<td>20.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ryan</td>
<td>20.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smith</td>
<td>20.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johns</td>
<td>17.03.1989</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>[Johns approved as co-author of credit submission]</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

THE ESSINGTON GROUP

3. Tibham Pty Limited $ 65m
   Carr 03.11.1988
   Ryan 02.11.1988
   Smith 03.11.1988
   Johns 02.11.1988
   [Johns’ approval confirmed 21.11.1988]

4. Mainsel Investments $ 31m
   Pty Limited
   Carr 27.04.1987
   Ryan undated
   Smith 28.04.1987
   Johns 23.04.1987

4. Mainsel Investments $ 11m
   Pty Limited
   Carr 08.06.1988
   Moyle 10.06.1988
   Ryan 09.06.1988

4. Mainsel Investments $ 17.9m
   Pty Limited
   Carr 22.03.1989
   Morton 21.03.1989
   Moyle 20.03.1989
   Ryan 20.03.1989
   Smith 20.03.1989
   Johns 17.03.1989
   [Johns approved as co-author of credit submission]
<table>
<thead>
<tr>
<th>Transaction report number (Volume 3)</th>
<th>Company</th>
<th>Facility Amount</th>
<th>Directors Approving</th>
<th>Approval Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.</td>
<td>Essington Developments Limited</td>
<td>$8.5m</td>
<td>Morton</td>
<td>20.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Moyle</td>
<td>20.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>20.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>20.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>17.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>[Johns approved as co-author of credit submission]</td>
</tr>
<tr>
<td>5.</td>
<td>Essington Developments Limited</td>
<td>$1m</td>
<td>Carr</td>
<td>27.04.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>undated</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>27.04.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>24.04.1989</td>
</tr>
</tbody>
</table>

**THE DAC - RELATED COMPANIES**

<p>| 6.                              | Direct Acceptance Corporation Limited | $20m | Moyle | 20.10.1986 |
|                                 |                                    |      | Rawlins | 21.10.1986 |
|                                 |                                    |      | Johns  | 14.10.1986 |
| 6.                              | Direct Acceptance Corporation Limited | $4m  | Carr  | 06.02.1987 |
|                                 |                                    |      | Ryan  | 06.02.1987 |
|                                 |                                    |      | Johns | 04.02.1987 |
| 6.                              | Direct Acceptance Corporation Limited | $3m  | Carr  | 01.05.1989 |
|                                 |                                    |      | Morton | 01.05.1989 |
|                                 |                                    |      | Smith | 01.05.1989 |
|                                 |                                    |      | Johns | 01.05.1989 |
|                                 |                                    |      |       | [Johns approved as author of credit submission] |
| 6.                              | Smith &amp; Lane Holdings Limited | $7.7m | Moyle | 11.08.86 |
|                                 |                                    |      | Ryan  | undated |
|                                 |                                    |      | Johns | 07.08.86 |
| 6.                              | Rocado Investment &amp; Finance Limited | $16m | Carr  | 02.05.86 |
|                                 |                                    |      | Ryan  | 01.05.86 |
|                                 |                                    |      | Johns | 29.04.86 |</p>
<table>
<thead>
<tr>
<th>Transaction report number (Volume 3)</th>
<th>Company</th>
<th>Facility Amount</th>
<th>Directors Approving</th>
<th>Approval Date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Moyle</td>
<td>24.02.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Rawlins</td>
<td>24.02.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>24.02.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>24.02.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>24.02.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>[Noted as approved at February board meeting.]</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>31.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>[Johns approved as co-author of credit submission; transaction possibly approved by other members at board meeting.]</td>
</tr>
<tr>
<td>6.</td>
<td>Bosane Pty Limited</td>
<td>$ 2.75m</td>
<td>Ryan</td>
<td>undated</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>11.06.1986</td>
</tr>
<tr>
<td>6.</td>
<td>Bosane Pty Limited</td>
<td>$ 0.25m</td>
<td>Ryan</td>
<td>undated</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>21.07.1986</td>
</tr>
<tr>
<td>6.</td>
<td>Amaldela Pty Limited</td>
<td>$ 4.3m</td>
<td>Ryan</td>
<td>undated</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>17.07.1986</td>
</tr>
<tr>
<td>6.</td>
<td>Churchill Leisure</td>
<td>$ 5.1m</td>
<td>Ryan</td>
<td>undated</td>
</tr>
<tr>
<td></td>
<td>Industries Limited</td>
<td></td>
<td>Johns</td>
<td>19.11.1986</td>
</tr>
<tr>
<td><strong>THE SKASE GROUP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Qintex Limited</td>
<td>$ 75m</td>
<td>Moyle</td>
<td>22.11.1985</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Hancock</td>
<td>26.11.1985</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Rawlins</td>
<td>22.11.1985</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>22.11.1985</td>
</tr>
<tr>
<td>8.</td>
<td>Qintex Australia Limited</td>
<td>$ 27m</td>
<td>Moyle</td>
<td>25.07.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>25.07.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>25.07.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>25.07.1988</td>
</tr>
<tr>
<td>Transaction report number</td>
<td>Company</td>
<td>Amount</td>
<td>Directors Approving</td>
<td>Approval Date</td>
</tr>
<tr>
<td>---------------------------</td>
<td>---------------------</td>
<td>----------</td>
<td>---------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td></td>
<td>Qintex Australia</td>
<td>$ 25m</td>
<td>Carr</td>
<td>14.12.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>13.12.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>10.01.1989</td>
</tr>
<tr>
<td></td>
<td>Kahmea Investments</td>
<td>$ 3.81m</td>
<td>Carr</td>
<td>09.10.1986</td>
</tr>
<tr>
<td>9.</td>
<td>Pty Limited</td>
<td></td>
<td>Ryan</td>
<td>06.10.1986</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>06.10.1986</td>
</tr>
<tr>
<td></td>
<td>Kahmea Investments</td>
<td>$ 39m</td>
<td>Ryan</td>
<td>02.07.1987</td>
</tr>
<tr>
<td>9.</td>
<td>Pty Limited</td>
<td></td>
<td>Moyle</td>
<td>02.07.1987</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>02.07.1987</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>02.07.1987</td>
</tr>
<tr>
<td></td>
<td>Kahmea Investments</td>
<td>$ 4.5m</td>
<td>Carr</td>
<td>08.03.1989</td>
</tr>
<tr>
<td>9.</td>
<td>Pty Limited</td>
<td></td>
<td>Moyle</td>
<td>15.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>08.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>03.03.1989</td>
</tr>
</tbody>
</table>

**THE MARKLAND HOUSE GROUP**

| 10.                      | Markland House      | $ 16m    | Moyle               | 17.04.1989      |
|                         | Limited             |          | Ryan                | 17.04.1989      |
|                         |                     |          | Smith               | 17.04.1989      |
|                         |                     |          | Johns               | 17.04.1989      |

| 10.                      | Ramuz Pty Limited   | $ 19m    | Morton              | 18.10.1988      |
|                         |                     |          | Moyle               | 19.10.1988      |
|                         |                     |          | Ryan                | undated         |
|                         |                     |          | Johns               | 14.10.1988      |

**THE BOND GROUP**

<p>| 11.                      | Dallhold Investments| $100m   | Moyle               | 05.02.1987      |
|                         | Pty Limited         |          | Ryan                | 04.02.1987      |
|                         |                     |          | Smith               | 04.02.1987      |
|                         |                     |          | Johns               | 02.02.1987      |</p>
<table>
<thead>
<tr>
<th>Transaction report number (Volume 3)</th>
<th>Company</th>
<th>Facility Amount</th>
<th>Directors Approving</th>
<th>Approval Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.</td>
<td>MEQ Nickel Pty Limited</td>
<td>$100m</td>
<td>Carr</td>
<td>22.12.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Morton</td>
<td>22.12.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>22.12.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>22.12.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>[Approved at December board meeting; Moyle not present; Ryan expressly declined to approve]</td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>MEQ Nickel Pty Limited</td>
<td>$4.9m</td>
<td>Carr</td>
<td>15.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Morton</td>
<td>15.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Moyle</td>
<td>15.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>15.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>16.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>15.03.1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>[Johns approved as author of credit submission]</td>
<td></td>
</tr>
</tbody>
</table>

**THE GOLDBERG GROUP**

<p>|                                     |                                |                | Ryan                | undated       |
|                                     |                                |                | Smith               | 22.04.1987    |
|                                     |                                |                | Johns               | 15.04.1987    |
| 12.                                 | Entrad Corporation             | $ 10m          | Carr                | 17.09.1987    |
|                                     |                                |                | Rawlins             | 17.09.1987    |
|                                     |                                |                | Ryan                | 16.09.1987    |
|                                     |                                |                | Johns               | 15.09.1987    |
| 12.                                 | Roxbury Holdings Pty Limited   | $ 22m          | Carr                | 16.09.1987    |
|                                     |                                |                | Rawlins             | 17.09.1987    |
|                                     |                                |                | Ryan                | undated       |
|                                     |                                |                | Johns               | 15.09.1987    |</p>
<table>
<thead>
<tr>
<th>Transaction report number (Volume 3)</th>
<th>Company</th>
<th>Facility Amount</th>
<th>Directors Approving</th>
<th>Approval Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.</td>
<td>GSH Investments Pty Limited</td>
<td>$30m</td>
<td>Carr</td>
<td>24.09.1986</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>undated</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>22.09.1986</td>
</tr>
<tr>
<td>13.</td>
<td>GSH Investments Pty Limited</td>
<td>$1m</td>
<td>Carr</td>
<td>14.10.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Morton</td>
<td>21.10.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smith</td>
<td>12.10.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>12.10.1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>[Noted that Moyle and Ryan unavailable]</td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td>GSH Finance Pty Limited</td>
<td>$10m</td>
<td>Moyle</td>
<td>24.07.1986</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ryan</td>
<td>undated</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Johns</td>
<td>15.07.1986</td>
</tr>
</tbody>
</table>
CHAPTER 16

THE RESPONSIBILITIES OF SBV’S DIRECTORS AND EXECUTIVES

A. Introduction

16.1 The first report (para 6.1) recognises that the business operations of SBV are not, in themselves, matters directly within the terms of reference of the Commission.

16.2 However, the terms of reference do make it necessary to consider some aspects of SBV’s activities (para 6.2). Some were examined fully in the first report, including the circumstances which led SBV to acquire Tricontinental (chapters 7-9), and the consultation between the State government and SBV regarding that acquisition and the conduct of Tricontinental’s business operations (chapter 24).

16.3 It is also necessary to look at the nature, extent, and effect of the supervision and control exercised by the SBV board over Tricontinental. A key aspect of this is the information given to the SBV board regarding Tricontinental’s operations.

16.4 A number of matters relating to those issues were examined in the first report:

- Investigation of Tricontinental’s lending portfolio and operating systems by SBV before purchase - paras 9.54-62
- Actions taken by SBV about particular problems noted before purchase - paras 9.68-84
16.5 More matters have been examined in this report, when considering the conduct of the Tricontinental board. In particular, the following matters are referred to in chapter 15:

- The role of SBV directors and executives as directors of Tricontinental - paras 15.8-91
- An attempt by Tricontinental management to obtain guidance from SBV about Tricontinental's corporate objectives - paras 15.121-122
- Issues relating to Tricontinental's capital adequacy - paras 15.165-184
- Issues relating to Tricontinental's concentration of risk - its lending limits for individual clients - paras 15.185-214.

16.6 This chapter examines some of these matters again, but this time from the viewpoint of the SBV board, with particular reference to the period from March 1985 (when SBV assumed control of Tricontinental) to May 1989 (when Tricontinental and SBV operations were integrated).

B. Membership of the SBV Board

16.7 In March 1985 SBV assumed control of Tricontinental's operations; in July 1985 it decided to acquire 100% of the shares in Tricontinental; and in May
1989 the SBV board resolved to integrate the operations of Tricontinental with those of SBV.

16.8 During this period the members of SBV’s board were Messrs J A Hancock (chairman), N A Smith (deputy chairman), I K Morton, I G Baker, I A Renard, D S Ironmonger, P R Marsh (resigned 23 November 1987), and L G C Moyle (appointed 23 June 1988).

16.9 Mr Moyle was appointed chief executive officer of SBV in August 1984, and became a director after the State Bank legislation was amended in May 1988. As a result of that legislation, members of the board ceased to be commissioners, and became directors of the new banking corporation (first report, paras 6.3-11).

16.10 Of Tricontinental’s directors, Smith, Morton and later Moyle were also directors of SBV, and Moyle, Rawlins and later Carr (in place of Rawlins) were executives of SBV. Mr Hancock, the chairman of the SBV board, was a director of Tricontinental for two short periods (see below).

16.11 Directors of SBV were appointed by the State government (first report, paras 24.90-91). On 22 February 1990, the Treasurer of the State of Victoria requested, and obtained, the resignations of all SBV directors. The circumstances in which that occurred are discussed in the first report at paras 24.95-97.

C. Qualifications and Appointments of SBV’s Directors

16.12 (a) James Arnold Hancock OBE

(i) Formal qualifications: Accountant - B Com (Melb), FCA, AASA, FIDA.
(ii) Professional and commercial background:

1952: Partner, Hancock & Woodward, chartered accountants

1964-1983: Chairman, Hancock & Woodward (later Hungerford, Hancock & Offner)

1984: Retired from accounting practice

1961-1984: Vice-Chairman, Commonwealth Serum Laboratories Commission

1978-1982: Member, Melbourne Underground Railway Loop Authority

(iii) Appointment to SBV board:

Appointed commissioner 1 July 1975
Deputy chairman from 1980
Chairman of board, credit committee and audit committee from 1983
Resigned 22 February 1990.

(iv) By 1985 SBV had acquired a 50% interest in Associated Midland Limited. Mr Hancock was a director, and in the second half of 1985 became chairman.

(v) Appointment to Tricontinental board:

Mr Hancock was a member for two short periods. The first commenced when SBV assumed control of Tricontinental in 1985. From 3 April 1985 to 31 December 1985 he was deputy chairman. The second period followed some months after Tricontinental’s operations were integrated into SBV. From 15 August 1989 to 23 February 1990 he was chairman of Tricontinental.

(vi) Role at Tricontinental:

The first period of appointment to the Tricontinental board (April - December 1985) gave Mr Hancock some insight into the affairs of Tricontinental that would have been of assistance in the later consideration of Tricontinental matters by the SBV board.

After SBV took control of Tricontinental in 1985, Mr Hancock asked that prudential arrangements for Tricontinental be documented, including
delegations and lending procedures, so that there could be a proper monitoring of those procedures and arrangements by the Tricontinental board. He said that a report by Mr Moyle to the SBV board on 26 June 1986, and the receipt of a copy of the guidelines from Mr Ziebell at about the same time, confirmed that his request had been acted upon. However, he did not actually review the documented policies, indicating that (having resigned in December 1985) that was a matter for the responsibility of the Tricontinental directors. It is noted that, in fact, written lending guidelines were approved by the Tricontinental board in November 1984, and that basically these were the guidelines referred to in June 1986.

Having regard to the brief periods for which Mr Hancock was a director of Tricontinental, his comparative lack of participation in the approval of major loan submissions, and the remoteness in time between his first period of appointment and the eventual collapse of Tricontinental, it is more appropriate to evaluate his role only by reference to his position as chairman of SBV from 1983.

(vii) Role at SBV:

When Mr Hancock became chairman of SBV in 1983, the bank had no formal budget and strategy planning process, no assets and liabilities committee, no audit committee and no credit ratings. Under his leadership SBV moved rapidly from a retail, domestic savings operation to that of a full service commercial bank. He created a credit committee, an audit committee, and enhanced the system of prudential controls. He also initiated a move to modernise the State Bank Act. This led to the new legislation that came into effect on 9 June 1988. As chairman of the credit committee, Mr Hancock spent many hours each week studying credit submissions, to be dealt with at the weekly meetings of the committee.
16.13 (b) Neil Andrew Smith

(i) Formal qualifications and commercial background:
- see para 15.8.

(ii) Appointments to SBV and Tricontinental boards:
- see para 15.8.

(iii) Role as chairman of Tricontinental:
- see paras 15.16-30.

(iv) Role as common director.

Although Mr Smith was chairman of Tricontinental, he never presented a written report to the SBV board. The explanation for this is discussed at para 15.22. He may have presented an oral report on an odd occasion when Mr Moyle was not available, but he said that this would have been exceptional.

16.14 (c) Lindsay Gordon Crossley (Bill) Moyle

(i) Formal qualifications and banking background:
- see para 15.10.

(ii) Appointments to Tricontinental and SBV boards:
- see para 15.10.

(iii) Role as a director of Tricontinental:
- see paras 15.51-60.

As noted above, it was Mr Moyle, not Mr Smith, who regularly reported to the SBV board upon Tricontinental matters.

(iv) Role as CEO and director of SBV:

Following appointment as chief executive officer in August 1984, Mr Moyle regularly attended SBV board meetings to report upon operations by SBV and its related companies. He was a member of the credit committee. Mr Moyle was appointed a director in June 1988, and resigned on 23 February 1990. After a period of leave, he resigned as chief executive officer in May 1990.
16.15 (d) Ian Kenneth Morton AM
(i) Formal qualifications and commercial background:
- see para 15.13.
(ii) Appointments to SBV and Tricontinental boards:
- see para 15.13.
(iii) Role as director of Tricontinental:
- see paras 15.81-91.
(iv) As a director of SBV, Mr Morton was a member of the credit committee from about 1985, and acted as deputy to the chairman of that committee.

16.16 (e) Ian Andrew Renard
(i) Formal qualifications: Solicitor - BA, LLM (Melb).
(ii) Professional and commercial background:
1983: Director, North Broken Hill Peko Limited.
(Mr Renard was also a director of several proprietary companies.)
(iii) Appointment to SBV board:
Appointed commissioner: 14 October 1981.
Director of several SBV entities - South Eastern Medical Complex Limited (chairman); Burdett, Buckeridge & Young Limited; trustee of StateGuard Friendly Society.
Member of the SBV audit committee, from its inception in January 1983.
Resigned: 23 February 1990.
(iv) Appointment to Tricontinental board:
Served briefly as a director of Tricontinental after the integration of its operations with SBV, from 12 October 1989 to 23 February 1990.
16.17  (f) Ian George Baker

(i) Formal qualifications:  Accountant - B Com (Melb) CPA

(ii) Administrative and commercial background:

1959-1971:  State Co-ordinator of Works
1961-1977:  Member, Local Authorities Superannuation Board
1969-1977:  Deputy Director of Finance, Department of Treasury
1977-1982:  Permanent Head, State Treasury
1982-1986:  Director of Finance, Department of Management and Budget
1984-1986:  Director, State Insurance Office
1987-1990:  Director, Transport Accident Commission

(iii) Appointment to SBV board:

Appointed commissioner:  28 September 1977
Director of SBV entities - South Eastern Medical Complex Limited, StateGuard Friendly Society.
Member of SBV's credit committee from March 1989.
Resigned:  22 February 1990.

(iv) Particular role at SBV:

Mr Baker was an ex-officio commissioner of SBV by virtue of his appointments in the Victorian Treasury. When the State Bank Act was amended in 1988, he became a director and the Treasurer's representative. He considered himself to be an independent director, exercising his own judgment. As the Treasurer's representative, he regarded it as his responsibility to check that SBV was adhering to statutory requirements; see first report paras 24.45-50.

Before his retirement from Treasury, in December 1986, he spent about 10% of his working time on SBV affairs. After retirement, this proportion increased to about 15% of his available time.

16.18  (g) Peter Ronald Marsh

(i) Formal qualifications:  Trade union official - B Ec (Monash)
(ii) Administrative and industrial relations background:
1971: Industrial research officer, Victorian Teacher's Union
1975: Research officer, Victorian Trades Hall Council
1985: Secretary, Victorian Trades Hall Council
1987: Deputy President, Victorian Trades Hall Council.

(iii) Appointment to SBV board:
Appointed: 26 October 1983

(iv) Particular role at SBV:
Mr Marsh accepted appointment as a commissioner at the request of the State Treasurer. His experience in industrial relations was seen as a benefit to the SBV board, at a time when SBV was experiencing industrial problems. He did not become a director of any subsidiary or associated SBV company.
As a commissioner, Mr Marsh was particularly concerned with the rationalisation of bank branches, negotiations for various wages and salaries, the conditions of part-time employment and banking industry awards, changes to the pension fund, problems with the introduction of Work Care, and dealing with the consequences of an increase in fraud and robbery from SBV branches.

16.19 (b) Duncan Standon Ironmonger
(i) Formal qualifications: Economist M Com (Melb), Ph D (Cantab).
(ii) Academic and administrative experience:
1949: Officer, Bureau of Census and Statistics (Cth)
1957-1960: Commonwealth post-graduate scholar, University of Cambridge
1963-1966: Director, Secondary Industry Division, Bureau of Census and Statistics
1966-1968: Senior research fellow, Institute of Applied Economics and Social Research, University of Melbourne

1970-1971: Fulbright senior research fellow, University of Pennsylvania


In addition, Dr Ironmonger was a reader in applied economic research at the University of Melbourne from 1969, and from 1983 held various teaching positions. He has published extensively in his particular field of expertise.

(iii) Appointment to SBV board:

Appointed: 14 December 1984
Resigned: 23 February 1990

Dr Ironmonger was a member of the remuneration committee and the salary review committee. He was also a director of South Eastern Medical Complex Limited, and StateGuard Friendly Society.

(iv) Particular role at SBV:

Dr Ironmonger brought to the board expertise as an economist and a knowledge of computing and statistics.

(v) Appointment to Tricontinental board:

He was a director of Tricontinental for a short period after the integration of operations, from 15 August 1989 to 23 February 1990.

D. SBV Executive Officers - As Directors of Tricontinental

16.20 (a) John St George Delme Rawlins

Mr Rawlins' qualifications, background and role as a director of Tricontinental, and his appointments as a treasury division executive at SBV, are described in paras 15.11 and 15.61-72. He occasionally attended SBV board meetings, to represent SBV’s treasury division.
16.21 (b) Raymond Maxwell Carr

Mr Carr's qualifications, background and role as an alternate director of Tricontinental up to April 1988, and as a director after that date in place of Mr Rawlins, and his appointments at SBV over a period of 40 years, are described in paras 15.12 and 15.73-80. His particular role in the round robin process used by Tricontinental directors for the approval of credit submissions is examined in paras 15.336-7, 15.340 and 15.374.

As deputy chief executive officer of SBV, he usually attended SBV board meetings, to assist Mr Moyle in reporting upon the operations of SBV and its subsidiary and related companies. After appointment as a director of Tricontinental in April 1988, he occasionally reported to the SBV board about Tricontinental's operations, if Mr Moyle was not available to do so. Mr Carr was a member of SBV's credit committee from September 1985.

E. Relationship Between the SBV and Tricontinental Boards

16.22 Para 16.4 above notes the references in the first report to the establishment of an autonomous Tricontinental board of directors, even though views were divided amongst SBV board members as to the future role of Tricontinental. Para 9.116 of the first report notes that the ambivalence of approach led to a degree of uncertainty about SBV's plans for Tricontinental in the months that followed the acquisition in 1985.

16.23 Since writing the first report, the Commission has received further oral and documentary evidence about the conduct of Tricontinental's business, and the nature of reporting and other relationships between the boards of Tricontinental and SBV. It has become abundantly clear that after SBV acquired 100% of Tricontinental, the SBV board kept clear of the day-to-day conduct of Tricontinental's operations. Nor, after that acquisition, did the SBV board give close consideration to the potential consequences should Tricontinental run into major problems with the quality of its lending portfolio.
16.24 It must be said immediately that a major reason why the non-common directors took this approach was because, from the time of SBV’s decision to acquire Tricontinental in mid 1985, right up to May 1989, repeated assurances were given to them that appropriate prudential policies and practices were in place with respect to all of Tricontinental’s operations, and that these were working effectively.

16.25 The assurances were mostly given by Mr Moyle. The implied, if not express, support of directors Smith and Morton, and SBV executives Carr and Rawlins, added to the weight of the assurances.

16.26 The information made available to the non-common members of the SBV board about the nature and conduct of Tricontinental’s operations is considered below.

F. Tricontinental’s Loan Portfolio at Acquisition

16.27 An appropriate starting point is the state of Tricontinental’s loan portfolio at the time SBV was considering the acquisition of Tricontinental.

16.28 The Touche Ross report to Mitsui (first report, paras 9.18-21) was discussed by the SBV board at its meeting on 26 March 1985. It highlighted the fact that Tricontinental had several major client groups whose loans constituted a major proportion of the company’s loan portfolio (first report, para 9.21).

16.29 Mr Smith referred to the high loan exposures of Tricontinental relative to its capital base, including a "couple" of loans between $40-$100m. He raised "the frightening aspect" that if one of these major loans failed, Tricontinental would be in a "negative situation" - that is, its liabilities would exceed its assets. Further, although Tricontinental’s portfolio was secured, it was "difficult to ascertain the nature" of that security (first report 9.36).
16.30 Tricontinental was discussed by the SBV board at a series of meetings over the following months. Mr Renard said in evidence:

"... we asked many questions at a whole series of meetings and specifically about the loans, and I was not concerned to find out so much about individual loans, I was concerned to know about the procedures that had been followed in assessing the adequacy and risks of the loan portfolio, and it seemed to me in the end that appropriate procedures had been observed ... what I was told at the time was that Mr Ryan had personally arranged for a review of the loan portfolio, that the results of his review were reported to an audit committee which was established, that simultaneously and independently the auditors of Tricontinental were requested to review the loan portfolio, and that the results of their investigations were reported to the audit committee. The audit committee included Mr Hancock, in whom I had, I think well justified, great faith in these matters, as well as Mr Moyle and Mr Smith ... they had reports on all significant loans, and the net result was that they had formed the view that the provisions were inadequate. They increased the specific provisions, and ... they had resolved to have an added general contingency of the order of $4m. I was told that the end result was that Mr Ryan was happy with that. His board thought that was appropriate. It seemed to me, as someone who was simply a member of the State Bank board that appropriate procedures had been followed."

16.31 Further details of SBV’s assessment are discussed in the first report, at paras 9.54-60 and 9.68-84. On 11 July 1985 Mr Moyle, in a memorandum to SBV directors, recommended that SBV acquire 100% of Tricontinental. The memorandum stated:

"The quality of assets has been of some concern. However, a thorough review of the asset portfolio has been undertaken. All non-performing accounts have been reviewed. Estimated losses on existing loans are approximately $8 million, just within the existing provision for loss. The proposed price discount is considered to fully protect SBV against any potential for loss arising from this or other factors" (first report, para 9.41).

G. Tricontinental’s Reports to the SBV Board

16.32 After acquisition of Tricontinental, the SBV board received operational reports on Tricontinental’s key performance results and data. These were usually
presented by Mr Moyle, as chief executive officer of SBV. This information was extracted from management reports to the Tricontinental board; it did not result from any separate reporting lines from the CEO of Tricontinental to the CEO of SBV. The reports to the SBV board usually covered the following aspects of Tricontinental's operations:

- profitability;
- liquidity;
- balance sheet aggregates;
- gearing;
- other business trends of note; and
- other major developments of interest.

16.33 Counsel assisting submit that up to November 1987, these reports were often oral rather than in writing, and that none was in writing after November 1987. In evidence Mr Moyle and Mr Hancock strongly contested that view. Mr Moyle had a clear recollection of the extraction of key data from Tricontinental board papers, and the distribution by him of a written summary to SBV directors at board meetings. The reports were expanded in discussion. Mr Hancock had a strong recollection of this occurring in 1988. In the absence of a complete set of the written reports provided to the SBV board, the Commission is unable to say with any certainty how often Mr Moyle's reports were in written form, and how often they were oral.

16.34 Whatever the frequency of written reports, it is clear that they did not tell SBV directors anything of the nature and quality of Tricontinental's loan portfolio, such as:

- the identity or nature of the borrowers;
- the concentration of the portfolio upon lending for shares and property;
- the size of individual loan exposures; or
- the extent of lending secured by shares.
16.35 Nor did the reports suggest any major difficulty with the quality of the portfolio, even after the stock market collapse in October 1987. Repeated assurances were given to the SBV board as to the adequacy of Tricontinental’s prudential policies and credit approval processes (see below).

16.36 Mr Hancock acknowledged that the reports did not contain any material which would have allowed the SBV board to make an informed assessment of the risks faced by Tricontinental in its lending business or whether the judgments made by the Tricontinental board were sound. He said the detailed aspects of Tricontinental’s lending and investment practices and risk assessment procedures were not the subject of discussion at the SBV board.

16.37 Nevertheless, Mr Morton - who was, of course, also a director of Tricontinental - described Mr Moyle’s reporting to the SBV board in respect of Tricontinental as responsive, full and frank.

16.38 Another Tricontinental director, Mr Carr, was not an SBV director, but he was present at most SBV board meetings. He said he was satisfied that the reports to the SBV board enabled it to have all necessary knowledge of what Tricontinental was doing by way of approval of loan submissions.

16.39 Mr Johns was never invited to an SBV board meeting to answer any particular concerns the board might have had, nor did Tricontinental management report directly to the SBV board.

16.40 Mr Renard took the view that information about individual Tricontinental loans was a level of detail which he thought it was not "incumbent on a non-Trico director to get into". He said that the written reports would not usually provide a break-up of the source of profits from the various segments of Tricontinental’s business, although he observed it was quite common in the oral presentation to provide more detail than was in the written reports, and occasionally Mr Smith or Mr Moyle would talk about particular departments
that were not performing well. At the end of 1988, with the possible exception of Tricontinental’s investment banking activities, Mr Renard was satisfied that Tricontinental was being conducted in a manner consistent with a properly run merchant bank. He believed it was a sound company with the potential to continue to earn reasonable profits. In reaching this conclusion, he relied very much on the regular reports and assurances given by Mr Moyle, and further information obtained from time to time, both formally and informally, from the other common directors.

16.41 When giving evidence, Mr Baker was asked to exercise hindsight, and comment on the quality and scope of the reporting to the SBV board about Tricontinental’s operations. He said:

"Clearly the reports were not adequate for the Board of State Bank Victoria to pick up possible problems in Trico. Now, the Trico Board obviously were not able to perceive them. Whether improved reporting or more detailed reporting and masses of figures and paper would have made that any better I do not know. I am not sure that it was the reporting from Trico to State Bank Victoria that is where the problem is. It is a step further removed, that if the Board we had on Trico were not able to perceive them, then the nature of the next step I do not think would have resolved it."

In answer to the direct question of whether the SBV board should have been more adequately informed, he said:

"Should have been more adequately informed, and how that could have been done, I don’t see the answer at the moment."

16.42 Mr Marsh said that the reports on Tricontinental’s operations were usually delivered orally by Mr Moyle or Mr Smith and "did not occupy a significant part of the board’s agenda. As best as I can recall all of the reports to the board on Tricontinental were generally positive in their outlook".

16.43 Dr Ironmonger said he was satisfied that he received appropriate and adequate information. In addition to the regular reports, he had available Tricontinental’s published accounts and relied on occasional discussions about Tricontinental at SBV board luncheons.
In addition to the operational reports, the SBV board also received Tricontinental’s annual reports. Minutes record the tabling of the reports for 1984, 1985 and 1986, but not those for 1987 and 1988. It appears likely, however, that this was simply an omission from the minutes. In any event, it is clear that each SBV director either received a copy of Tricontinental’s annual reports, or could readily have obtained them if he wished.

It was, of course, necessary for SBV directors to give some consideration to the operations of Tricontinental, and to Tricontinental’s financial statements before being able to consider and sign off the SBV group’s consolidated accounts. There was evidence from Mr Hancock, Mr Baker and Dr Ironmonger that they recalled reading the Tricontinental annual reports. It is safe to assume that Mr Renard did so, too. Mr Moyle dealt with Tricontinental’s yearly results in his reports to the board, and they were noted in SBV’s credit submissions for facilities granted to Tricontinental.

Between April 1985 and May 1989, the SBV audit committee comprised Mr Hancock (chairman), Mr Renard and Mr Moyle. It met six times in 1986, four times in 1987, and six times in 1988. It did not meet in 1989 until 7 June.

Counsel for the SBV directors, and counsel assisting the Commission, express differing views in their submissions as to the measure of comfort that the SBV directors were reasonably entitled to derive from the SBV auditors’ reports regarding the consolidated financial statements of the SBV group. These differing submissions were based in large part upon the differing conceptions held by counsel as to the role of auditors of a holding company in placing reliance upon the work of another auditor. The most that can be said is that, in providing their report on SBV’s financial statements, SBV’s auditors impliedly represented, in accordance with professional auditing standards, that
they had satisfied themselves that they could rely upon the adequacy of the audit work undertaken by Tricontinental's auditors in auditing Tricontinental's financial statements.

16.48 Between September 1987 and May 1989, no fewer than five valuations of Tricontinental - two in draft form, and a third rejected - were prepared by Coopers & Lybrand. These reports were obtained to support the various attempts to dispose of Tricontinental: the proposed float in late 1987, the plan to "back-door" list Tricontinental using Pine Vale in 1988, and the proposed merger with Australian Bank Limited in 1989. The valuations are described in the first report at paras 12.17, 14.34-35, 15.13-14 and 15.45-55. Mr Renard and Mr Hancock sought to derive some comfort from the contents of these reports, which valued Tricontinental between a high of $228m in 1987, to a low of $90m in 1989.

16.49 However, as Mr Renard noted and Mr Hancock agreed, the Coopers & Lybrand reports did not comment on or analyse the underlying assumptions upon which the valuations were based, and Coopers & Lybrand emphasised in each report they had not carried out any independent confirmation of the information which was provided to them. In particular, they did not inspect the accounting records of Tricontinental, nor did they conduct anything in the nature of an audit of those records.

16.50 These sources of information regarding Tricontinental need to be seen by the context of the broader duties of the SBV board. As noted by Mr Renard, Tricontinental's operations were but a part of a large amount of business that the SBV board was obliged to consider. It was hardly surprising that the non-common directors should, in these circumstances, rely heavily upon the information provided to them by Mr Moyle and the other common directors as to Tricontinental's operations.
The Growth and Size of Tricontinental's Loan Portfolio

16.51 Clearly, all of the SBV directors were well aware of Tricontinental's rapid growth in lending, and of the size of the loan portfolio. This would have been evident from a variety of sources available to them, most particularly, Tricontinental's financial statements, and, more pressingly, Tricontinental's need for increasing large stand-by credit facilities from SBV, and for annual capital contributions.

16.52 The rapid expansion of Tricontinental's loan portfolio place constant pressure upon its gearing ratio. Chapter 21 of the first report examines the funding of Tricontinental's rapid growth. The maximum gearing ratio guideline of 25 to 1 set by the Tricontinental board is discussed in paras 21.12-15, and the nature and extent of SBV's financial support in paras 21.35-44. As noted in para 21.38, in the three years 1986-1988, SBV provided capital in support of Tricontinental's gearing ratio as follows:

- June 1986: $15m subordinated loan
- June 1987: $10m additional share capital
- June 1988: $8m subordinated loan

The contributions in 1987 and 1988 were reinvestments of the dividends budgeted for those years from Tricontinental.

16.53 In addition, SBV extended a variety of credit facilities to Tricontinental which, at December 1988, totalled $310m (refer para. 21.41 of the first report). SBV's credit exposure to Tricontinental was the subject of continuing discussion between the Reserve Bank and SBV. RBA prudential guidelines required that SBV limit its exposure to not more than 30% of SBV's capital base. When Tricontinental ran into a liquidity crisis in March 1989, SBV sought and obtained the RBA's approval to increase its facilities to Tricontinental to 40% of its capital base. It provided further support by purchasing loan assets from Tricontinental.
I. Tricontinental's Prudential Policies and Practices

16.54 As early as June 1986, the SBV board was asked to provide support for Tricontinental's expansion of lending, in the form of additional stand-by credit facilities. Although it agreed to expand its facilities to Tricontinental at that time, it made its position plain. Mr Renard said in evidence:

"We were very near the limit of the amount we could fund, and the directors asked the common directors to go back to Trico and tell them in no uncertain terms that we were not a bottomless pit and they should conduct their operations in such a way that they should not necessarily expect any more loan funds from us."

16.55 At the meeting on 26 June 1986, the SBV board had before it a credit submission dated 23 June 1986, which recommended, among other things, that a subordinated loan of $15m be granted to Tricontinental for three years, to provide additional capital. It also recommended that SBV's maximum aggregate exposure limit to Tricontinental be increased from $300m to $342m for a period of three months. The recommendations were signed by Mr R A Woolastion (chief manager corporate banking) and Mr J E Franklin (senior manager corporate banking).

16.56 The submission noted that Tricontinental's internally set balance sheet gearing ratio of at 25 to 1, and potential gearing ratio of 35 to 1, were expected to be exceeded, and that $15m additional capital was needed to bring them into line by 30 June 1986.

16.57 The credit submission stated:

"Provided that the bank's board is satisfied with the prudential controls exercised by Tricontinental, the facilities extended by the bank must be considered as being under adequate management control. However, prudence dictates that the bank's exposure to Tricontinental and indeed Tricontinental's own growth be predicated on the group's capital base and that continual increasing support cannot be assumed"
16.58 SBV’s secretary made notes of the discussion that took place. Mr Renard observed that the submission presented no view on the adequacy of Tricontinental’s prudential controls. He questioned how the board could decide that it was satisfied with the prudential controls exercised by Tricontinental. The secretary’s notes record Mr Moyle’s response:

"CEO advised that Trico is reviewing its reporting and prudentials. Last board reviewed reporting to board. All delegated lending reported in list form. Board sees all above $3m. CEO on board lending committee. Not quite same as bank but of good standard. NS asked that minutes record that CEO happy with prudentials."

("CEO" refers to Mr Moyle. "NS" refers to Mr Smith.)

16.59 The official board minutes record Mr Moyle’s assurance in the following terms:

"The chief executive officer reported on the current operations of Tricontinental Holdings. On the subject of prudential controls, he stated that the Tricontinental board has recently reviewed and satisfied itself with management reporting related to money market and investment activities of the company. Appropriate delegations for lending were in place and lending approvals and applications were considered to be subject to proper analysis and consideration both by management and the board."

16.60 In evidence, Mr Renard said his clear recollection was that while Mr Moyle said controls at Tricontinental were not identical to those at the bank, he left the SBV board in no doubt that he was very happy and confident with them. Mr Renard said, however, that Mr Moyle had not indicated what these prudential standards were. Mr Renard did not consider that it was either necessary, nor appropriate, for SBV directors to demand details of Tricontinental’s prudential standards. He felt it would have been interference on his part to have enquired into the details of such matters. Mr Renard said that when assurances were given by Mr Moyle as to prudential controls and guidelines, he assumed similar controls operated at Tricontinental as were in operation at SBV, such as exposures limited by a monetary amount and as a proportion of Tricontinental’s capital base. He did not know the actual limits.
Mr Renard summarised the extent of the SBV board's enquiry regarding Tricontinental's prudential policies and practices in the following terms:

"I never asked chapter and verse of what the prudential controls were, but we sought and obtained assurance that they were in place ... there is a fine line between supervising sufficiently to make sure that all our investments are sound and safe and secure, which was certainly our job, and taking over the job of the Tricontinental board and performing it for them. That would have been an interference and an unwarranted intrusion and that is something that a non-executive director has to be very careful not to do."

At another point in his evidence, Mr Renard said that it would be proper to intervene if the SBV board had a concern as to the way in which Tricontinental was conducting its business, but that:

"I think a non-executive director works on a system of having a comfort level, if you like. He asks various questions and if he gets responses which seem reasonable, seem well thought out, seem consistent with what else he is being told, he passes on to the next topic, of which there were many. Trico was a tiny portion of what the State Bank was talking about. If, however, you start to get answers that seem ill thought out or hasty or inconsistent, well, of course, you hopefully latch onto that point and pursue it."

It is reasonable to expect that the other non-common directors held views similar to those expressed by Mr Renard. In any event, it is clear on the evidence that they were not aware of the details of Tricontinental's lending policies and practices. Mr Hancock, as chairman of SBV, had been sent a copy of Tricontinental's lending guidelines by Mr Ziebell in June 1986 (first report, para 9.79). He only glanced at them. As a director of SBV, he felt no obligation to read them. (It is noted that he had not been a director of Tricontinental since the end of 1985.) Dr Ironmonger relied upon the assurance that had been given. He was concerned only to ensure that Tricontinental's management and board had satisfied itself as to the existence of appropriate standards. He took the view that Tricontinental was not to be treated as a department of SBV, but as a different institution dealing with a different market that should have its own different prudential controls appropriate to that market.
Mr Moyle agreed in evidence that he, in reporting to the SBV board regarding Tricontinental's prudential policies, did not provide specific details as to what those policies were. Mr Moyle simply gave an assurance that he was familiar with the prudential controls at Tricontinental, and was satisfied with them.

Counsel for the directors (and particularly in their capacity of acting for Mr Moyle) submit to the Commission that in giving these assurances to the SBV board, Mr Moyle was properly relying upon the reports to the Tricontinental board by its managing director, the absence of any criticisms by the internal auditors of Tricontinental, the absence of any concerns expressed by the Reserve Bank, and what counsel described as "positive assertions" by the external auditors of Tricontinental and SBV, and of Australian Ratings. The auditors and Reserve Bank dispute these submissions.

Although Mr Renard did not ask for details of Tricontinental's prudential policies and practices, he did maintain a continuing interest in being satisfied that they were adequate, and were being observed.

This concern was shown in relation to an SBV credit submission dated 20 May 1987 which reviewed SBV's existing maximum credit exposure limit to Tricontinental, which then stood at $342m, and recommended an extension to 31 March 1988. The recommendation was signed by Mr R M J Escudier (assistant general manager corporate banking), Mr J Attoe (chief manager corporate banking), and Mr Franklin. The submission was approved by the SBV board at its meeting on 25 June 1987.

Before the board meeting, Mr Smith, Mr Moyle and Mr Morton, as directors of Tricontinental, had written to SBV on 17 June 1987. They referred to the proposed extension, and signed a statement which was intended to satisfy a requirement of SBV's procedures for lending which required the SBV commissioners to be satisfied that SBV had "effective control" of a subsidiary to which it provided credit facilities, and to be satisfied "with the prudential
management controls" of the subsidiary and of the "adequacy of reporting to the Commissioners".

16.69 In seeking to enable SBV to be satisfied as required, the Tricontinental directors had written:

"To facilitate a formal annual review of the bank's facilities to the Tricontinental group, we hereby state that:

(1) the bank's shareholding and conditions pertaining thereto are such as to provide the bank with effective control over the Tricontinental group; and

(2) the prudential lending controls exercised by the Tricontinental group are understood to meet the bank's requirements"

16.70 At the board meeting on 25 June 1987 Mr Renard questioned this wording. The secretary's notes record that:

"IR queried why letter of comfort re prudential controls etc was not signed by executive of Tricontinental - he had difficulty in accepting the wording and letter viz 'understood ... bank's requirements'. It was agreed that the letter should be reworded and re-executed to reflect that Tricontinental directors acknowledge that SBV has absolute control of Tricontinental and that they are satisfied with the prudential controls that exist in the company"

16.71 Mr Renard said in evidence that he believed the letter had later been redrafted and signed by the directors in accordance with the request. He believed that, before signing, they had obtained an appropriate "certificate" from Mr Johns, as chief executive officer of Tricontinental.

16.72 Having received assurances in July 1985, June 1986 and mid 1987, Mr Renard was satisfied that the loan portfolio had been reviewed both as to the risk involved and the nature of the portfolio, and he was satisfied that it conformed to appropriate prudential standards. He was aware of detailed prudential standards at SBV. He assumed that similarly detailed prudential standards were in place at Tricontinental.
Aspects of Tricontinental’s lending, its gearing ratio and the implications that had for SBV’s own tight capital position, and Tricontinental’s profit performance, were all matters that came before the SBV board from time to time up to the integration of Tricontinental’s operations into SBV in May 1989.

At the SBV board meeting in August 1987, when Tricontinental’s financial results for the year ended 30 June 1987 was discussed, Mr Renard was recorded as being "pleased with the result, but warned that if exposed to $21m profit, must also be exposed to losses of similar amounts. Should be wary of downturns".

Two months later, in October 1987, the stock market "crashed". On the question of lending secured by shares, Mr Renard said in evidence:

"... if I had been a director of the merchant bank I would have received and listened to a submission that in certain circumstances loans secured by shares might be appropriate, but my warning bells would be out and you would have to take extreme caution. I certainly would not say that it’s never appropriate for a merchant bank to lend secured by shares."

On 7 October 1987 a special meeting was called for the SBV board to discuss the proposed float of Tricontinental. A board paper dated 5 October 1987 had been prepared by Mr Carr. He informed the board, among other things, that Tricontinental’s prudential guidelines were being "progressed by management to cover the future new relationship between the bank and the company". The proposed information memorandum for the float referred to Tricontinental’s credit policy and prudential management in the following terms:

"... credit policy and prudential management are directed to the maintenance of high quality loan assets and a balanced portfolio. This avoids undue exposure to any industry segment by regional company/industrial group. Credit appraisal and risk management are by a system of delegated authority through a committee system."
16.77 At the SBV board meeting on 29 October 1987, Mr Moyle referred to the impact of the recent stock market collapse. The secretary's notes record the following comments about Tricontinental:

"CEO reported from recent Directors meeting. Results to 30/9 show profit ahead of plan with good contribution from corporate funding group. Since end of September quarter, liquidity had been maintained with good credit lines in place including $190m from SBV. 11.00am book maintained at $350m. Non performing loans declined down to 1 1/4%. Whole portfolio reviewed particularly where shares securities involved. Investment banking portfolio value decreased. Capital market area not a problem. Trading risks are being controlled. Overall group is meeting pressures well and minimising risk of loss. Trico float not now proceeding."

16.78 At the SBV board meeting on 26 November 1987, a short memorandum presented to the directors by Mr Moyle gave a clean bill of health to Tricontinental following the stock market crash, noting that Tricontinental profits were currently running ahead of plan, and although gearing ratios were under pressure, non-accrual loans were steady at $45m, compared to $26m at 30 June 1987.

16.79 An SBV credit submission, dated 30 November 1988, was an annual review of SBV's credit facilities to and dealing limits with Tricontinental, which then stood at $305m (plus an international dealing limit of US$20m). A recommendation, signed by Mr Attoe and Mr Franklin, proposed that the facilities and dealing limits be extended to 30 November 1989. The submission was approved by the board at its meeting on 8 December 1988.

16.80 The review noted that Tricontinental's "strong rating" of AA- had been given in view of SBV's ownership and Tricontinental's "strong capacity to meet unsecured debt obligations". It was also noted that the rating had permitted access to lower cost funding, and greater access to unsecured deposits. Tricontinental's contribution to SBV's group profits was noted as approximately $26m in 1987 and $23m in 1988. The review commented upon Tricontinental's accounts for the year to 30 June 1988 as shown below.
Under the heading "Profit and Loss", the review stated:

"The Tricontinental Group encountered turbulent market conditions in the 1987/88 financial year by way of increasing competition and a deterioration in business confidence during the period immediately following the downturn in global stock markets.

As was the case with most financial institutions, Tricontinental suffered as a result of the October stockmarket collapse and was not able to escape the financial ramifications of a severe correction. The diminution of security values (equities) resulted in a high level of write-offs and increased provisions for bad debts.

Bad debt write-offs increased 324% from $6.7m to $28.4m. Provisions for "contingencies" (doubtful debts, investments etc.) has also been increased from $12m to $17.5m. Consequently, despite gross revenue increasing by 22% and gross trading profit (before bad debt provisions) also increasing on last year, operating profit (NPBT) declined 20% from $41.3m in 1987 to $33.1m."

Under the heading "Developments", the review noted that, in the light of changing market conditions, Tricontinental had moved to diversify business activities, and to spread its sources of income. In addition to "the reliable income stream generated on its extensive loan portfolio", Tricontinental had:

enhanced its reputation as a major lender in the commercial property market by participating in major projects,
remained competitive and achieved further growth in corporate lending ...."

Under the heading "Balance Sheet", the review stated:

"The Group's level of total tangible assets improved by 22% to $3.146b. Contributing to this result was the Group's loan portfolio which experienced continued growth. Committed facilities now total $4.03b, up from $3.4b in 1987. Also reflected in the movement in asset values is the increase in Investments, up from $74.8m to $138.473m. However, it should be noted that approximately $25.0m in unrealised losses on Listed Share & Convertible Notes are evidenced when comparing book value to market value at balance date. The relative note to the account (Note 10) reads: "The nature of the Group's business produces certain contingent risks particularly in the recovery of debts, eventual realisation of the book value of investments and trading securities. Due to the inherent difficulties in quantifying the individual risks, a lump sum provision has been created to an amount considered to be realistic". The relative provision is disclosed as a
current liability of $17.5m, up from the $12.0m for 1987. This provision represented 0.43% of the Group’s total lending commitments of $4.03b which could be considered inadequate based upon the level of write-offs that occurred this year however, the level of provisions is an increase on provisions as a % of total lending commitments as at June 1987 which was measured at 0.35%.

After discussing Tricontinental’s liquidity position (with the conclusion that liquidity appeared to be "adequate"), the review of the balance sheet turned to Tricontinental’s gearing:

"Total Shareholders Funds, with retention of approximately $17.0m in current year earnings, has increased from $91.6m in 1987 to $108.4m at balance date. Gearing as depicted in our financial spreads now stands at 28.43 times (1987 27.58 times) which is over the accepted convention of 25 times for the merchant banking industry. However, of significance is the increase in ‘quasi-capital’ provided by the Bank by way of fully subordinated loans. If these loans are treated as equity, gearing would be reduced to a more acceptable 23.22 times which conforms with industry expectations."

The annual review concluded with the following summary:

"Although gearing levels remain in the upper level of prudential guidelines, the Group’s operational performance in acknowledged difficult conditions has remained profitable, albeit at levels below the 1987 record results. A 23.4% return on shareholders funds must be considered excellent under the circumstances. Significant write-offs have been allowed for and whilst restraining profit growth this year should allow for a return to positive profit growth in the ensuing years. Additional contingency provisions have also been allowed for in this regard. Given the group’s excellent operational performance over the past few years; its ability to compete favourably in the marketplace; its significant market presence; and the strong support of its parent, the extension of existing facilities is supported."

Clearly, the non-common directors of SBV could reasonably have derived some degree of comfort from this assessment, given the general economic circumstances since the October 1987 stock market collapse, but of course the ‘sleeper’ in it was that the perceived strength of Tricontinental was in part due to "the strong support of its parent". Also, the submission acknowledged
significant write-offs, and diminished profit, but did not offer any critical analysis of Tricontinental's loan portfolio.

16.87 At the board meeting on 22 December 1988, Mr Carr said that the Reserve Bank was questioning Tricontinental on various matters relating to the proposed ABL merger. Mr Renard questioned whether future profit performance could suffer. Mr Carr was confident Tricontinental's profit was secure, but said that "... big write-offs appear necessary".

16.88 Following announcement of the proposed merger of Tricontinental with ABL, the issue of a "RatingWatch" by Australian Ratings in January 1989 and delays in completing the merger resulted in a sustained and debilitating "run" on Tricontinental's funding, requiring SBV to provide liquidity support. An SBV credit submission, dated 5 April 1989, proposed that the existing limit of $305m be increased by $11m to $316m (plus the US$20m limit). Significantly, the submission included a list of "prime risks", and contrasted them with "mitigants". This is the earliest example found of this SBV method of examining credit risk. One of the risks listed was that "Trico would normally be dealing with a more entrepreneurial type of client than trading banks, hence greater credit risk applied". The "mitigants" to this risk (and the others listed) were said to be:

"... defined credit guidelines; high level of secured borrowings; widespread of clientele; established suitable collection techniques and sound receivables management; acceptable bad debt level to date; substantial standby lines (parent support); proven track record and strong market presence."

16.89 The January 1989 RatingWatch in respect of Tricontinental was noted as being the result of the proposed Tricontinental/ABL merger and "a deterioration in Tricontinental's financial profile, evident on the release of its 1988 Annual Report". A trading loss of $3.8m for the six months to December 1988 was noted, but no cause was suggested for the decline in profitability.
Again, the credit submission provided no analysis of Tricontinental's loan portfolio. Nor was there any discussion in support of the list of "mitigants".

The SBV board considered this submission at its meeting on 6 April 1989, and resolved to increase Tricontinental's facilities to $347m, which was more than the limit sought in the submission. At the same time it approved the purchase of further Tricontinental assets by SBV for $117m, and it authorised the sending of a letter of comfort to the Reserve Bank, confirming SBV's support for Tricontinental, with the object of improving Tricontinental's ability to attract and retain funds by obtaining a 50% risk weighting for bank deposits with Tricontinental.

An SBV credit submission, dated 2 May 1989, requested the board to "formalise" an increase in Tricontinental facilities from $316m (not $347m as above) to $426m, plus (an increased) US$25m. At the prevailing exchange rate this gave a total maximum exposure limit equivalent to $457m. The proposed increase followed the consent by the Reserve Bank for SBV to lift its funding support for Tricontinental to the equivalent of 40% of SBV's capital base. This consent was given on the understanding that the exposure would be reduced to not more than 30% as soon as practicable, and, if necessary, by asset sales on Tricontinental's part. A number of the comments in the preceding submission of 5 April 1989 were repeated, including the same list of risks and "mitigants". On this occasion specific reference was made to the liquidity crisis that Tricontinental was undergoing, as this was the main reason for increasing the facilities. At the meeting on 11 May 1989 the board resolved to increase the exposure limit as proposed.

J. Tricontinental's Exposure Limits

At the meeting held on 22 January 1987, the SBV board adopted a new set of prudential and control ratios for the bank. These included the maximum exposure limits for lending by SBV to various categories of borrowers.
In the case of loan facilities to borrowers other than subsidiaries of SBV and other banks, the prudential exposure limit adopted was:

"(b) the maximum aggregate limit for financial exposure to a company or entity group be determined at 20 per centum of the Bank's capital, with the maximum aggregate unsecured portion being limited to 15 per centum of the Bank's capital."

There is no suggestion, either in the documents presented to the board meeting, in the minutes, or in the evidence of SBV directors, that this policy was intended by the SBV directors to authorise Tricontinental to lend up to an amount equivalent to 20% of SBV's capital base to individual borrowing groups. The Commission finds that the policy was intended by SBV directors as being applicable only to lending by SBV itself.

The notes taken at the meeting by SBV's secretary, Mr Horsley, included the following:

"CEO will discuss principles of report with Trico for implementation by it. Need for co-ordinated interaction by the two groups noted."

The "report" referred to in the notes was the one by SBV management which proposed the new prudential ratios. While the precise meaning of this note is unclear, the Commission concludes that the "need for co-ordinated interaction" was not intended by SBV directors to be a suggestion that Tricontinental could lend up to the same limit per client as SBV itself. That certainly is the tenor of the evidence of the directors.

There is no suggestion, in the material relating to the SBV board meeting on 22 January 1987, that Mr Moyle expressly raised with SBV directors the matters discussed at the meeting of the Tricontinental board on 23 July 1986, particularly the proposal that Tricontinental could lend up to $100m, a sum equivalent to about 20% of SBV's capital base at the time, to a client group (see paras 15.188-200 above). Mr Smith and Mr Morton were also present at
the SBV meeting, but there is no suggestion that they referred to the Tricontinental discussions or arrangement either.

16.99 Mr Moyle said in evidence that, although there was never a formal submission or minute on the matter, he believed it was understood at SBV board level that there was a limit on Tricontinental's lending and that the limit was around the figure of $100m. He said that the SBV board was aware of the fact that loans in the order of $100m were being made by Tricontinental because they were seeing individual cases in SBV credit submissions relating to common clients, with the Tricontinental exposures noted on them. He was satisfied that in relation to common borrowers most of them would have ended up at the SBV board table so directors would all have seen a number of the large exposures, for example Skase, Bond, Herscu. There was also general discussion at informal meetings of the SBV board members as to exposures to such entrepreneurs.

16.100 Mr Morton said that, although the practice of aggregating loan exposures was not formally acknowledged by the SBV board, he believed that it was well understood by the SBV board. Although "the bank did not write us a letter saying, 'you are hereby this and that'", the SBV board nevertheless acknowledged the reality of the situation "by an impression I formed by being a regular attender at the meetings of the State Bank board". Mr Smith could not recall any discussions at SBV board level about an aggregated maximum exposure policy. Mr Morton and Mr Smith were, of course, directors of Tricontinental.

16.101 Mr Carr was also a director of Tricontinental, and was usually in attendance at SBV board meetings in his capacity of an SBV executive. He said that he believed that the SBV directors were aware that Tricontinental had six clients who had each borrowed more than $100m. When asked whether they also appreciated that in six other cases there was an exposure in excess of $50m
each, he answered "I believe they had an understanding of the activities of Tricontinental".

16.102 Mr Baker gave evidence that he had not been aware that Tricontinental’s maximum loan exposure policy was determined by reference to SBV’s capital base, but he added:

“As I think I have made it clear, it doesn’t surprise me that that may have been the case, but I do not think I would have heard it expressed exactly in those terms at board level ... I think I would probably have to say that I would have a similar impression [to that of Mr Morton], that in the overall banking operation that that may well have been happening, but it was never laid down in any document”

16.103 Mr Renard said that he was aware that Tricontinental was relying upon its relationship with SBV because, without that relationship, it could not have supported, in the market, a gearing ratio of 25 to 1. That limit, however, related to the total size of Tricontinental’s loan portfolio, not to the size of individual loan exposures. Mr Renard was not aware of any arrangement between SBV and Tricontinental whereby Tricontinental could lend amounts of up to the equivalent of 20% of the capital base of the SBV to an individual borrower, nor of any policy for the aggregation of loan exposures to individual borrowers by SBV and Tricontinental, any consideration by the Tricontinental board as to exposure limits, or any discussions on the matter between Mr Moyle and Mr Johns.

16.104 Although Mr Renard was not a member of SBV’s credit committee, the Commission considers it almost certain that he would have been aware of, and remembered, any such arrangements if they were common knowledge among SBV directors.

16.105 Dr Ironmonger did not recall any meeting of the SBV board (either formal or informal) which involved a discussion of the maximum amount which Tricontinental could lend to an individual borrower or group, or that such exposures were to be determined by reference to any percentage of SBV’s
capital base. He said he was rather surprised to learn from the evidence before the Commission that this sort of discussion had been going on, but had not reached the SBV board. The issue of concentration of risk was, he believed, under proper management at Tricontinental. He said that, in fact, he did not really turn his mind to the nature or extent of the Tricontinental loan portfolio. This was a task for his colleagues in full command of the whole organisation. Going over this at the SBV board would be a great duplication of effort.

16.106 Submissions by counsel for the directors concede that the non-common directors of SBV were aware of certain borrowers having large facilities with Tricontinental, but deny that they were aware of the extent of Tricontinental's exposure to individuals or groups. They say further that many organizations were aware of the large exposures, including Australian Ratings, the auditors, investigating accountants, and the Reserve Bank, and that none had perceived this to be a problem which could not be managed.

16.107 It is further contended by counsel that the SBV board members were entitled to rely on the common directors to inform them of any problems faced by Tricontinental, and that the common directors did inform them of all the relevant matters which they believed needed to be reported to a parent company. Moyle, Smith and Morton (along with everyone else at the time) did not perceive there to be any problems which required their attention as directors of Tricontinental, or which required reporting to the SBV board.

16.108 On the all-important subject of concentration of risk, Mr Renard's evidence was particularly interesting. He was asked to comment on the fact that Tricontinental had extended facilities to six groups of related entities for amounts in excess of $100m each, and a further five groups had been granted facilities in excess of $50m each. In the final analysis most of these groups had collapsed. His reply was:
"The first time I found that out was in June 1989 in a discussion of the audit committee at which the auditors were present. I remember my reaction well; I was most disturbed."

Later he said:

"There's no sin in lending a very large amount of money to just a few people .... It is the combination of how much money have you lent to people who you could fairly assess give rise to significant risk, and does the structuring of the loan and the security you have in place properly reflect that degree of risk."

He explained that, in referring to the structure of the loan, he had in mind competing priorities with other lenders, and the choice of entities who might be the borrower in a particular group.

Later again, when asked what circumstances would make such lending unacceptable, he said:

"... There is no inherent problem in an organization lending money to quite a small number of borrowers, provided that the risk profile of the particular borrowers justifies the amount lent to them, and that the structure and security of the loan adequately takes account of that. ... I would say that if I was presented with a list of borrowers and that list included a large number of borrowers who, in my subjective assessment, were medium to high risk borrowers, and the amounts lent to them were of such a nature that if a number of them failed to repay the amounts lent, that the whole future of the company would be endangered, then I would say that that point had been reached."

K. Tricontinental's Loan Portfolio

SBV directors who were not directors of Tricontinental were aware of the total size of Tricontinental's loan portfolio, and they were aware of the names of at least some of Tricontinental's higher profile borrowers. They did not know of Tricontinental's exposure limits, but they knew that there were some large loans. How much more did they know about the individual clients, the size of the exposures, and the nature of the transactions?

One view is that they only had to read the newspapers and financial journals, and the Australian Rating reports regarding Tricontinental, to become aware
that a great deal of support was going to a relatively short list of entrepreneurs, with lending focussed upon shares and real estate, and including loans that were excessive unless measured in the context of SBV's capital base.

For example, an article in the Financial Review, dated 12 February 1986, stated that "Tricontinental's client base reveals a glittering constellation which lends credence to the bank's self-styled image of banker to the stars", and named as clients Peter Laurance, Stanley Hambley, George Herscu, Alan Bond, Solomon Lew, John Gandel, Bob Ansett, Jack Chia, John Avram and Mark Besen. It was also noted that Tricontinental had become one of the leading banks for Christopher Skase.

The article went on to quote Mr Johns as saying:

"We were criticised for going down market but Trico picked the trend and has secured its market share at a time when competition is burgeoning ... This is a sector where risks are greater but profits are potentially greater .... We stay closer to our clients, get our hands dirty, and consequently have very few bad debts despite our practice to give quick authorities for loans .... We will lend 100 percent of the capital to a client after closely examining the deal and we never say "no" straight away. It's harder to say 'no' than 'yes' because when you refuse a loan application you have to justify that refusal."

It was also reported that, "Johns estimated that 28 percent of the bank's lending portfolio was devoted to property while about another 28% percent was devoted to funding people into equities".

The above article had come shortly after one in Australian Business, published on 29 January 1986. Under the heading "Young 'gun' really firing", it reported:

"Tricontinental's Ian Johns may be one of merchant banking's youngest managing directors, but he is no babe in arms when it comes to lending substantial sums to successful entrepreneurs.

Johns, 32, who took up his new appointment as managing director on January 1, was largely responsible for the raid on Enacon shares by
Boley Investment's Peter Hunt and Stephen Matthews last November. Within a couple of hours he gave the go-ahead for 100 per cent funding on the $7 million share grab on Lee Ming Tee's Australia-based empire."

The article also stated:

"Johns says there are no immediate proposals for change - 'at this stage, just more of the same'."

An article in The Australian, on 15 February 1986, covered much the same ground as the Financial Review. It quoted Mr Johns as naming Skase, Bond, Lew, Herscu, Goldberg, Besen, Gandel, Alter and the late Paul Fayman as clients of Tricontinental, and as saying:

"Some of our clients have been knocked back by other institutions. They say 'no' because something hasn't happened before. I find it personally difficult to say no - I have to justify it. When people have an idea, cash flow and potential - and the idea makes sense - I say 'do it'."

The article also quoted Mr Johns on the subject of competition from the newly established foreign-owned banks:

"I think we all have some advantage over the foreign banks. They have difficulty understanding how you can lend $2 million to a company with a deficit of shareholders' funds making losses but with large assets and the principal driving around in a Rolls Royce. They think the company should be making a profit and paying tax."

As a final example of reporting which tended to lionise Mr Johns during the 1986-1987 period, 'Australian Business' reported in its 24 June 1987 edition, in awarding Tricontinental the award of "Most Improved Company":

"Johns, the 1986 Bulletin Young Executive of the Year, has continued to develop Trico in the classic merchant banking mould. He is personally uncomfortable with suggestions that he has turned the company around and believes the real key to its improvement was the advent of the State Bank as a 100 percent shareholder."

After referring to a lack of direction from the top in the days of consortium ownership, Johns was quoted as stating:

"The State Bank has given us a strong commitment to growth and they fully realise the need for competitiveness if we wish to stand above the crowd."
The article continued, quoting Johns again:

"I take a hands-on approach, and I'm pretty market oriented. The team [at Tricontinental] knows it's being supported."

Once again, a list of client names was set out, similar to those mentioned above.

"We used to be criticised for doing business with some of these people, but now our competitors are in there after their business."

These various press reports were not put to Mr Johns in evidence for comment as to whether he was quoted correctly (although, as it turns out, the substance is fairly accurate). Nor were they put to SBV directors to find out whether they had been aware of them at the time, or for comment upon Johns' perception of SBV's attitude.

What does emerge from the articles is an insight into the atmosphere which prevailed in the 1986-1987 period, before the share market collapse in October 1987, and evidence that the general nature of Tricontinental's business strategy and the names of its leading clientele had become matters of common knowledge in financial circles by early 1986.

The Australian Ratings reports were another readily available source of information about the nature of Tricontinental's lending business and its clients. The May 1987 report stated that:

"... asset growth has been achieved through the acceptance of a number of large secured exposures, particularly to unlisted entrepreneurial companies ... lending is on a secured basis and well spread across broad industry groups, although there appears to be a bias towards private entrepreneurs and property and construction finance, including shopping centres and commercial/investment projects."

The February 1988 report was expressed in similar terms, stating that:

"In the main, lending is on a secured basis and is well spread across broad industry groups, although there is a bias towards investment finance and property and construction finance, including shopping centres and commercial/investment projects. At 30 June 1987 these two
areas each represented about 30% of total lending commitments and are subject to an upper ceiling of 33%. Within the portfolio there is also a heavy incidence of lending to private entrepreneurs and investment companies”.

The Commission, however, is not aware of any evidence that shows that the non-common directors of SBV were aware of the contents of these reports, and Mr Renard has stated in evidence that he was not aware of Tricontinental’s heavy lending in the areas of investment finance and property development referred to above.

16.122 It is also noted that Tricontinental’s annual reports contained significant information about the nature of its lending activities, particularly its focus upon lending for commercial real estate acquisition and development. As discussed previously, the SBV directors were aware of the contents of these reports (see paras 16.43-44 above).

16.123 Mr Hancock was chairman of SBV’s credit committee, and stated that it was the practice of the committee (presumably after the new exposure limits of 22 January 1987) to take Tricontinental’s exposures into account when approving SBV loans to common clients, and that “on occasion” an exposure of Tricontinental would result in a “cut back in the loan approved” by SBV. He could not recall any specific instances of a Tricontinental loan exposure.

16.124 Mr Renard denied any detailed knowledge of Tricontinental’s individual loans after July 1985 and before May 1989. He did not accept Mr Moyle’s view that the size of Tricontinental’s loans were known by some if not all SBV directors - so far as the non-common directors were concerned. He was aware in 1988, from anecdotal sources, that Tricontinental had a $100m loan to Dallhold, but from that he did not imply that there might have been other loans of similar size.

16.125 The individual loans were a level of detail which he “didn’t think it was incumbent on a non-Trico director to get into.” Mr Renard considered that to
have sought specific details of Tricontinental's policies from Mr Moyle would have "been interference and unwarranted intrusion, and that is something that a non-executive director has to be very careful not to do".

16.126 Mr Renard said that concentration of risk was never alluded to by Mr Moyle in discussions or assurances he gave to the SBV board. He had no idea of the break up of Tricontinental's loan portfolio. He denied any knowledge that Tricontinental lent heavily for real property development. He said that his impression was that Tricontinental's clients were generally "industrial companies based in Melbourne".

16.127 He said that it was a "very rare" event for a Tricontinental loan exposure to be shown in a SBV credit submission - there was little overlap between clients for lending purposes. He had "very little knowledge of the actual details of Trico loans", and did not believe that the other non-common directors had any greater knowledge.

16.128 It is clear that a distinction needs to be drawn between clients of SBV who were also borrowers from Tricontinental, and those who only dealt with Tricontinental on the money market. Mr Renard said that "Trico had an exposure to virtually every one of our corporate borrowers" as a lender or borrower on the short term money market.

16.129 The consideration of aggregated exposures to common clients was explained by Mr Renard as follows:

"What I knew was, as I think we have previously explained, that occasionally a State Bank loan submission would come through, in which a credit facility from Trico to the same group would be disclosed. This was a customary practice from early 1987 onwards, virtually every submission there would be a disclosure of the Trico exposure, but in the main, that was merely money market dealing limits, and foreign exchange limits. There were a few cases that I can remember. I can remember one specifically, but I am sure there were others, when the State Bank was proposing to lend to a client and a credit facility from Tricontinental was already in place, but that was a fairly rare event,
and I had very little knowledge of the actual details of Trico loans, and I do not believe other non-Trico directors had any greater knowledge than I did."

16.130 It appears that the information exchanged between executives of Tricontinental and SBV about large lending exposures did not find its way to the SBV board. Indeed it was always intended that it would be closely held. To the extent that it was used in the compilation of SBV credit submissions and annual reviews about facilities made available to Tricontinental, no reference was made to individual exposures.

16.131 Nevertheless, Mr Renard apparently had some inkling of the general nature of Tricontinental's clients in 1987. In evidence, he said that he was concerned about the proposed 1987 float of Tricontinental, because it was suggested that the float could be done without a registered prospectus. He was also concerned about the list of prospective shareholders in Tricontinental, and the way in which it was suggested that the shares be allotted to them. When asked what concerned him about the list of shareholders, Mr Renard said:

"... what concerned me was that so many borrowers of Tricontinental were on the list. Whilst none of them individually one would necessarily take exception to, if you took them as a list, there was a who's-who of the entrepreneurial end of the Australian capital market."

16.132 Mr Renard later corrected his description of these prospective shareholders as "borrowers". He explained that he didn’t know with certainty that these "entrepreneurs" were borrowers from Tricontinental - "that was not told to me" - but he:

"... wondered if that was so, because they were obviously people who Mr Johns had a good acquaintance with because he was the one who produced the list, so it would not have surprised me if they were borrowers from Tricontinental ... I suspected that they were clients of Tricontinental in some way or other, but frankly, if I drew any inference from it, the principal inference I drew was that they were clients in the
investment banking activities - in other words, Trico would have been an underwriter or investor in shares in those companies and was probably a corporate adviser. Whether Trico lent money to them, I had no idea.*

In evidence Mr Renard wrote down, from the best of his recollection, a list of those large clients of Tricontinental of which he was aware in 1988. Later in evidence, that list was compared with a list of Tricontinental's large exposures, at 30 June 1989, prepared at about that time by Tricontinental's auditors.

Seven of the eight names on Mr Renard's list appeared on the auditors' list (one client had repaid by 30 June 1989). Significantly, however, none of the five biggest borrowers on the auditors' list had been known by Mr Renard to be a client of Tricontinental. Indeed, of the eight biggest borrowers named on the auditors' list, only one had been known to Mr Renard, yet Tricontinental's exposures to those eight borrowers totalled $1,000m.

When asked to describe his assessment of the names on his own list, he said:

"...they are nearly all companies headed by Melbourne-based businessmen, whose reputation is known to me, and whilst they are not all exactly equal standing, as a group they represented people who would have had substantial assets, and were regarded after the crash as people likely to withstand the effects of the crash .... To my knowledge, of the eight names there, only one has collapsed, .... and one other ... has obviously had some difficulties. But to the best of my knowledge, the other six companies have all come through the crash relatively unscathed."

Mr Renard said that when he was first given the names in the auditors' list, at an audit committee meeting in June 1989, after integration, "the actual figures and the names as a group certainly came as a surprise". He said "I remember my reaction well, I was most disturbed". Compared to his own list, there were "a number of other names there which are clearly high-risk."

Dr Ironmonger said the reports to the SBV board by Mr Moyle did not disclose the identity of borrowers of Tricontinental in any systematic way.
There may have been some occasional reference to a particular borrower, but there was no detailed look at the internal portfolio of the borrowers from Tricontinental. He had no particular understanding of the identity of Tricontinental's borrowers, other than the comments in the Touche Ross report in early 1985. Nor was there any attempt to identify the security underpinning the loans - that was for the Tricontinental board, not the SBV board. He had a general awareness that some Tricontinental loans were secured by shares, but no detailed knowledge of the particulars of such arrangements. The review of Tricontinental's loans prepared by Mr McAnany, about June 1989, was the first detailed investigation available to the SBV board.

16.138 Mr Baker stated that, as he recalled it, the SBV board was not informed of details such as the identity of Tricontinental's borrowers, the type of securities being provided, or other aspects of Tricontinental's loan portfolio.

L. Other Issues

16.139 (a) Tricontinental's investment banking activities

The role of Mr Johns in the conduct of Tricontinental's investment banking activities has been examined in chapter 15 above, as has the responsibility of the Tricontinental board as a whole.

16.140 Mr Renard said that he had a reasonable perception of how active Tricontinental was in the investment banking field through his familiarity with underwriting issues coming before the stock exchange, and that his impression was that Tricontinental was "concentrating in the second half of the market for listed companies and were probably one of the leading underwriters for the companies once you get past the top 100".

16.141 Counsel assisting submit that Tricontinental's investment banking activities were characterised by an absence of documentation and serious questions as to possible breaches of the Companies Code, involving warehousing, acquisitions of share parcels and insider trading. They submit that not only is
the Tricontinental board in breach of its responsibilities for permitting Mr Johns to dominate this activity, but so too the SBV directors should have known this was the situation, and have taken steps to establish an appropriate policy.

Counsel for the auditors urge the same approach. They also refer to comments made in September 1988 by a director of Burdett, Buckeridge & Young, the stockbroking subsidiary of SBV, to Mr Renard about the personal and professional attitude of Mr Johns to investment banking. Mr Renard had passed on these remarks to Mr Hancock, Mr Moyle and Mr Rawlins.

The evidence discloses that Mr Renard only became aware in early 1989 of the existence of separate categories of Tricontinental’s investments called "category A" and "category B", and did not see the actual list of investments until after May 1989. Nor did he know, before July 1989, that the auditors had expressed some concern about a lack of documentation in relation to a number of investment banking activities. Dr Ironmonger’s evidence on this issue was to the same effect.

The Commission does not accept the contention by counsel assisting (supported by counsel for the auditors) that the non-common directors should have known about Mr Johns’ domination of the investment banking activities, or the possible areas of criticism concerning those activities.

Nor does the Commission accept the contention by counsel for the auditors that the Burdett, Buckeridge & Young incident should have triggered an investigation of Tricontinental’s investment banking practices, at the instigation of the SBV board. The view taken by Mr Renard at that stage (September 1988) was not unreasonable - that "there was no much we could do about changing the cultural chasm", and that the comments by Burdett, Buckeridge & Young simply "confirmed our desire to sell Tricontinental".
(b) Proposed float of Tricontinental, 1987

16.146 At the meeting on 7 October 1987, the SBV board considered the proposal to float Tricontinental. Mr Renard gave evidence that the received a large batch of documents, many inches thick, late on the previous afternoon. He read them "until some appalling hour - I think about 3 am", and went to the meeting the next day questioning, in particular, whether there ought not to be a prospectus issued. It was agreed that the question should be referred to solicitors for advice. Although he raised a number of other points during the meeting, Mr Renard was not satisfied that all issues had been considered by the end of it and, at Mr Hancock's suggestion, he dictated a memorandum about his remaining concerns to Mr Hancock's secretary. The resulting document was tendered in evidence and illustrates Mr Renard's very careful approach to his responsibilities.

16.147 As events turned out, the stock market collapsed two weeks later, and the proposal was dropped.

16.148 Reference has already been made to Mr Renard's concern about the list of prospective shareholders to whom it was proposed that shares be issued in the float (see paras 16.131-132 above). He was very concerned that SBV, remaining a substantial shareholder for a time at least, would be closely associated with the people named.

(c) Proposed listing of Tricontinental, 1988

16.149 Another point at which Mr Renard became concerned about Tricontinental was when the proposed back door listing through Pine Vale Investments was discussed by the SBV board in mid 1988; see first report, paras 14.44-45. He gave evidence that there were two matters about which he was uncomfortable, the more significant being that Tricontinental and another company which Mr Renard knew to be a close ally of Tricontinental had each bought significant parcels of Pine Vale shares, which between them amounted to well over 20% of the total shareholding. If the two companies were shown to be associates,
this would have been a very clear breach of the Companies (Acquisition of Shares) Code.

16.150 Mr Renard was so concerned about these matters that he pressed Mr Smith, as chairman of Tricontinental, to seek outside legal advice. Mr Smith agreed to do so and, after a time, reported back to Mr Renard that the independent legal advice had been favourable to the proposal. Mr Renard said that he was still concerned, but felt that he could do no more. In the event, of course, the sale of Tricontinental to Pine Vale did not proceed; see first report, paras 14.27-42.

16.151 Mr Renard gave evidence that he took particular interest in these attempts to dispose of Tricontinental because his particular field of expertise in the law was mergers and acquisitions.

(d) Media report, July 1988

16.152 Another occasion when something about Tricontinental caused concern to Mr Renard was on 20 July 1988, when he read an article about Mr Johns which he said "...greatly heightened my alarm, and I took action appropriately...". Later he said that he pursued this matter assiduously.

16.153 The Commission did not pursue this question in detail, because it related to certain allegations which are presently before the courts. However, the Commission has no reason to doubt Mr Renard's claim that he was concerned and raised the issues involved with the appropriate persons in SBV. There seems to have been nothing more that he, as an individual board member of SBV, could have done.

(e) Proposed Tricontinental-ABL merger

16.154 When the question of SBV giving warranties to Australian Bank in respect of Tricontinental's loan portfolio arose in May 1989 (first report, paras 15.56-57), Mr Renard arranged to call upon Mr McAnany at his office at SBV.
McAnany had been responsible for reviewing the existing loans of Tricontinental to determine which could be bought by SBV to assist Tricontinental with its liquidity crisis (first report, paras 15.67-69). McAnany's state of mind at this time, and Renard's account of their conversation on 18 May 1989, are to be found in the first report, paras 17.10-11. Mr Renard stated in evidence:

"McAnany seemed agitated and angry. He told me that the loan portfolio was a disgrace. He said it was much worse than merely not meeting the Bank's lending criteria. He said a number of the loans were under-secured and poorly structured, and the portfolio reflected very poorly on all responsible for it. He strongly urged me not to support any warranty to ABL in regard of the loans."

(f) Special SBV board meeting, 21 May 1989

It is sufficient for present purposes to say that Mr Renard was very concerned by what Mr McAnany told him about the quality of Tricontinental's major loans. Because of this, when a special SBV board meeting was called for Sunday 21 May 1989, Renard arranged to meet McAnany again before the board meeting, at about noon, to ensure that he was fully briefed about the situation before the meeting began at about 2.00pm. The minutes of the meeting show that Mr Renard took a major part in making sure that all possible options for SBV were fully canvassed.

(g) Post-integration activities

After the decision to integrate had been taken, Mr Renard devoted a great deal of time to the work of the SBV audit committee, which reviewed all Tricontinental's major loans and decided the necessary level of provisioning for losses associated with the portfolio. In September 1989, a provision of $400m was identified as being necessary.

When Mr Moyle informed the SBV board, on 16 November 1989, that even this provision was inadequate, and that a further $200m would be needed, Mr Renard, after giving the matter careful thought, suggested that the board should initiate a full inquiry into the causes of Tricontinental's losses. The
chairman, Mr Hancock, agreed in principle, but said that he would be guided by the majority view of the board. The idea of an inquiry was opposed by Mr Smith, Mr Moyle and Mr Morton, for different reasons. In the event no inquiry was initiated, although it must be remembered that there were several accountancy firms conducting inquiries into particular loans, and giving independent advice to the SBV board, at this time.

M. **Performance by SBV’s Directors**

16.158 A number of matters relating to the performance by the SBV board are dealt with in the first report and elsewhere in this report - see paras 16.2-5 above. These include the appointment of an autonomous Tricontinental board, the selection of the particular directors, and the appointment of Mr Johns as managing director. The Commission finds that in the circumstances existing at the time, each of those decisions was a choice reasonably and properly open to the SBV board.

16.159 Chapter 15 contains the Commission’s evaluation of the conduct of the common directors, Messrs Smith, Morton and Moyle, as directors of Tricontinental.

16.160 The major criticism to be made of the common directors, as directors of SBV, is that they failed to report to the SBV board a true picture of the state of affairs at Tricontinental. This was not a matter of wilful deception, but their conduct did fall short of the proper performance of their obligations to SBV. This came about as an inevitable consequence of their falling short of the proper performance of their obligations to Tricontinental - as discussed in chapter 15.

16.161 This is not to say that they necessarily should have reported matters of detail. The SBV board was not required to be treated as a duplicate Tricontinental board.
16.162 The major fault lay in the giving of assurances that appropriate prudential policies and systems were in place, and that they were operating effectively. As discussed in detail in chapters 11 and 15, that was a long way from the truth.

16.163 For that, Mr Moyle must accept primary responsibility, for he gave the assurances and, coming from him, they carried great weight and were properly accepted at face value by the non-common directors.

16.164 However, Mr Moyle was supported, either expressly or impliedly, by his fellow common directors, Mr Smith and Mr Morton. The SBV executives, Mr Rawlins and Mr Carr were in a somewhat different position. They could not realistically have been expected to differ from their chief executive when in attendance at SBV board meetings, given their subsidiary roles there. On the other hand, there is no evidence that they wished to differ.

16.165 The other major matter, for which Mr Moyle must also accept direct responsibility, was his support in July 1986 for Tricontinental to lend up to $100m per client group, equivalent to approximately 20% of SBV's capital base, without obtaining the clear and express approval of the SBV board of directors. The result was that Tricontinental could accept the same individual exposures as SBV itself by placing reliance on the capital backing of SBV, effectively committing SBV to bear the risk associated with Tricontinental's lending in a different risk segment of the market, with markedly different internal controls and procedures from SBV.

16.166 It is extremely significant that this matter was not raised clearly and directly with the SBV board for endorsement. It is almost certain that it would have triggered off a line of enquiry by the SBV board which could well have led to a major modification in Tricontinental's operations - by reducing its exposure limit, or tightening up its actual lending performance, or quite likely both.
16.167 It is difficult to escape the conclusion that this was a confrontation that Mr Moyle deliberately chose to avoid. He knew that he did not have willing executive support from Mr McAnany and Mr Escudier on the question of Tricontinental’s exposure limits. And there is little doubt that his motivation was to hold on to the status quo in Tricontinental until the company could be sold. In the meantime it was desirable to maintain the profitability of Tricontinental’s operations, in the hope of achieving a useful capital gain upon disposal.

16.168 Again, Mr Smith and Mr Morton must be associated with Mr Moyle’s actions. At the very least, they were aware of what Tricontinental was lending, to whom, and on what terms, and were content to leave their non-common directors in ignorance of the full facts as to the credit risks.

16.169 It was one thing for SBV’s commercial banking division and Tricontinental to be at arm’s-length in a competitive environment. It was another thing altogether for the common directors to permit Tricontinental to engage in a pattern of lending that had the potential to bring down SBV itself - as indeed did happen - without giving the full board of SBV an opportunity to consider its position.

16.170 Mr Smith showed some concern over the potential impact of Tricontinental’s loan portfolio in March 1985 - there must have been vastly greater cause for concern in later years, when the loan portfolio expanded beyond recognition, and was intensely concentrated upon the activities of a small group of entrepreneurial high-fliers. As already noted in para 16.134, at 30 June 1989 the exposure to the top eight borrowers was $1,000m.

16.171 The non-common directors were in a quite different position. It has been convenient to focus upon Mr Renard when considering their position. This has been done for a number of reasons:
First, he impressed as a reliable witness. While recognising that no witness ever has perfect recall, and all are capable of error at times, the Commission feels able to place considerable reliance upon Mr Renard's evidence. It is all the more willing to do so because he showed, throughout his testimony, both a careful choice of words and a good deal of objectivity.

Secondly, he said he had a particular interest in Tricontinental, amongst the many matters that came before the SBV board.

Thirdly, the records of SBV meetings confirm that he frequently asked probing questions about Tricontinental.

Finally, if there were limits to what Mr Renard knew, then it was not likely that the other non-common directors would be any better informed.

In the event, the evidence bore out the last point. There were very substantial areas of the conduct of Tricontinental's business about which Mr Renard knew nothing, and the other non-common directors were no better informed.

When Mr Renard was first appointed to the SBV board in 1981, he prepared himself carefully for meetings by reading all the board papers, and then was prepared to listen and learn. However, in a short space of time he became critical of the adequacy of the material being placed before the board and started to draw attention to this situation. He found support from the chairman, Mr Hancock, and over a period the position was much improved.

Mr Renard made it a practice, after reading the board papers, to give advance warning of any significant issues that he wanted to raise. This, at least, produced the result that executive officers were fully prepared to deal with his questions and, sometimes, he would receive either an additional briefing paper or a telephone call of explanation from the executive concerned.
Despite this attention to his role, Mr Renard's evidence revealed a long list of matters of detail concerning Tricontinental about which he knew nothing. These included:

- Details of prudential policies and standards, particularly regarding large exposures.
- The identity of many of Tricontinental's clients.
- The size of individual loan exposures.
- The resulting concentration of risk in loan portfolio.
- The extent of lending secured by shares.
- Tricontinental's heavy lending for property acquisition and development, hotels, office or retail complexes.
- The existence of Tricontinental's project finance division.
- Concerns by Tricontinental's auditors over the lack of documentation for investment banking transactions.

The Commission accepts the simple proposition that, in the ordinary course of events, the non-common directors were not required to know about matters of detail in the conduct of the subsidiary's operations. As Mr Renard was at pains to point out, there are limits as to what a non-executive director of a parent board need, or even perhaps should, enquire into, in the absence of some special reason for doing so. In the Commission's view, a reasonable suspicion that the true position was being misrepresented (or awareness of facts which should give rise to such a suspicion) would be a reason entitling, indeed obliging, a director to press for further information.

Counsel assisting make a number of submissions about the common directors, as directors of SBV. Counsel submit that they:

- Had sufficient information to understand the type of borrowers to whom Tricontinental was lending.
- They knew of some very high exposures, and should have inferred that these must have rested on the strength of SBV's capital base.
They were obliged to satisfy themselves as to the character of Tricontinental's loan business.

They were negligent in merely relying on general assurances provided by common directors or senior executives, and in acting on the assumption that all was well at Tricontinental.

Mr Renard was by far the most active and concerned in regard to Tricontinental's operations, but even he failed to go far enough.

These directors should have required the common directors or the Tricontinental board to provide written reports, at least on an annual basis, which were calculated to expose the real nature of Tricontinental's lending business.

So armed, they could then have made an informed decision to intervene in Tricontinental's affairs.

Counsel assisting submit further that, in all the circumstances, all SBV directors failed to act with reasonable care and diligence in the discharge of their obligations to establish policy for, and to supervise, the activities of Tricontinental. This failure was a contributing cause of Tricontinental's demise and the ultimate losses which it suffered.

Counsel for Mr Renard and Dr Ironmonger accept that the SBV directors had an obligation to supervise the activities of the Tricontinental board. To enable them to do that they had to monitor the performance of the subsidiary. However, they contend that all that was required of the SBV board was to obtain and receive appropriate assurances from the Tricontinental board, and from the common directors, that the procedures and lending guidelines which had been put in place by the Tricontinental board were appropriate, and were being adhered to by management. They submit that the SBV board did receive assurances and, further, that they were not put on notice as to any matter which would cause them to doubt the assurances that had been given.
Heavy reliance was also placed by counsel upon the structure of the Tricontinental board, including as it did the deputy chairman of SBV, the CEO of SBV, the most senior non-executive director of SBV, and three of its most senior executives (including Mr Ryan, a former senior SBV executive, for this purpose). It is submitted by counsel that the other SBV directors acted with reasonable care and diligence in relying upon such a subsidiary board.

It is relevant to note what Mr Renard had to say about the common directors:

"Mr Moyle, Mr Morton and Mr Smith have something in common and that is that all of them have been a chief executive of a very large and successful organization; all of them have served on boards of directors; all of them are acquainted with the difficulty with getting to grips with areas of business with which they are not necessarily an expert. I had observed each of the three of them over a long period of time as directors of the State Bank and though they differed very much in the way in which they approached that task, each of them in his own way was a very impressive director. ... Mr Smith has an ability to pick up an issue and run with it; he is very astute and frank. Mr Morton is a cautious person who has a wealth of experience and has the ability to listen to a long discussion, not necessarily comment much, but at the end make the telling comment that sums up the position and indicates precisely what must be done. Mr Moyle always impressed me as an immensely competent banker and leader and tactician of a large organization."

Mr Renard was also entitled to rely upon the fact that Mr Hancock had made important and valuable changes to prudential controls when he became chairman of SBV. Mr Moyle had also played a role in tightening up procedures at SBV and, at all times, expressed himself as fully satisfied with those in operation at Tricontinental. In the view of the Commission, the non-common directors had no reason to try to go behind the assurances that they received from Mr Moyle.

The records show that Mr Renard was conspicuously attentive to matters concerning Tricontinental. In the Commission’s view, he asked the right questions at the right time, and received apparently satisfactory answers.
From July 1985 to May 1989 there were complete assurances about the adequacy and effectiveness of Tricontinental's prudential policies, and the soundness of the loan portfolio. There was not a hint that any bad debts or doubtful loans were not adequately covered by appropriate provisions.

In the light of the evidence of Mr Renard, supported as it is at many points by contemporary documents, the Commission is unable to identify any point at which Mr Renard failed in his duty as a director of SBV to take an appropriate interest in the affairs of Tricontinental.

Although the degree of interest in Tricontinental established by Mr Renard cannot be attributed to the other non-common SBV directors, those directors are entitled to take comfort from Mr Renard's activities. They heard the issues which he raised at board meetings and are entitled to rely, just as much as he, upon the answers he received. To put the matter another way, if Mr Renard had no reason to doubt the health of Tricontinental before integration, then there is nothing that Mr Hancock, Dr Ironmonger, Mr Baker or Mr Marsh could reasonably be expected to have done to produce a different result.