



MINISTER FOR FINANCE AND TREASURY

Minister's Statement to Parliament: 9th August 2011

On

Sovereign Community Infrastructure Treasury Bills Financing for Kokopo Infrastructure Program

Mr. Speaker,

There has been much controversy in recent times that has given rise to statements and counter statements, media reports and correspondences, on the Sovereign Community Infrastructure Treasury Bills (SCITB) financing for the Kokopo Infrastructure program.

My statement today, is to shed light on what has transpired according to the information that the Department of Treasury and the Bank of Papua New Guinea has collated to-date.

Mr. Speaker,

On 5 March 2010, the former Treasurer entered into an Investment Management Agreement with National Capital Limited. This engaged National Capital Limited to be the issuing agent for K125 million of Treasury Bills, called Sovereign Community Infrastructure Treasury Bills, for financing Water and Infrastructure Development projects in the Kokopo District purportedly on behalf of the State. This was witnessed and endorsed by the former Minister for National Planning and District Development. A term sheet was prepared for investors containing the details of the SCITBs and signed by the former Minister for National Planning and District Development in March 2010.

National Capital Ltd recommended that Nasfund purchase the SCITBs in their capacity as Nasfund's fund manager.

The SCITBs were issued for a period of one year, at an interest rate of 7.05%. This was close to the interest rate on Treasury Bills at auctions at the time of issuance which was around 6.5%. The money was to be held by National Capital Limited who was to pay contractors outside of Government systems. The issuance was arranged by Malco (PNG) Pty Limited, a private company directed by Mr. Alan Waters.

The raising of these funds and the associated expenditure on infrastructure in Kokopo **were not** included in the National Budget.

Mr. Speaker,

The Constitution, at section 209, requires that all raising and expenditure of funds by the National Government must be authorized by Parliament through the National Budget. Cabinet or individual Ministers **do not** have the power to authorise National Government expenditure.

The State Solicitor provided legal advice in March 2010 which was reinforced by the former Attorney General Sir Arnold Amet's advice to the then Prime Minister early this year. The advice was that the issuance of the SCITB was unconstitutional and illegal because it did not comply with *Section 209* of the *Constitution* and the *Public Finances (Management) Act*.

The Department of Treasury or the State Solicitor did not sanction this arrangement and were unaware that the SCITBs were issued until the media broke the story in March 2010. The Department of Treasury and the State Solicitor had previously advised the former Treasurer that similar schemes were unconstitutional.

On discovering that Nasfund intended to purchase the SCITBs, the Department of Treasury again advised the former Treasurer that the scheme was unconstitutional and strongly recommended that he rescind the arrangement he had made with National Capital Limited.

Mr. Speaker,

The proponents of the SCITBs and the previous Attorney General Hon. Ano Pala have argued incorrectly that the scheme was legal.

The first argument they put forward is that the *Treasury Bills Act 1974* gives the Minister the power to issue Treasury Bills to fund expenditure which is not included in the National Budget. This is incorrect as all legislation must be read in the context of the Constitution and individual Acts cannot give Ministers the power to bypass Constitutional requirements.

The second argument is that a Treasury Bill is somehow not a loan. A Treasury Bill is a short term financing instrument which must be repaid within one year. While a Treasury Bond, or Inscribed Stock, is a long term financing Instrument which is repaid over a period greater than one year, they are both used by the Government to **borrow** money to finance budget expenditure and they are both loans.

Therefore, Mr. Speaker, I have to report that the previous Treasurer exceeded his legal authority and did so against the advice of his Department and the State Solicitor.

Mr. Speaker,

I want to present some background information on the Kokopo Infrastructure Projects.

On 27 October 2009, the former Treasurer received a request from the then Minister for Communications and Information Technology for financing of key and strategic development projects for Kokopo for US\$100 million (approximately K300 million) from the Chinese Government. However, the project was not included in the Development Budget. Furthermore, the money that the Chinese had allocated to PNG was already fully committed to other projects.

In October 2009, Mr. Alan Waters, director of Malco, was appointed by the former Minister for Communications and Information Technology to be the Exclusive Coordinator for Corporate Advisory, Fund Raising, Fund Management and Legal requirements for providing infrastructure in Kokopo which would be guaranteed by the State.

In January 2010 Malco was appointed by the former Treasurer to be the Exclusive Coordinator of a special purpose Treasury Bill for infrastructure in Kokopo. Malco then appointed Backwell Lombard Capital to sub underwrite the issuance. Backwell Lombard Capital is the parent company of National Capital Limited.

Mr. Speaker, the appointment letters indicate that the project's proponents knew that the expenditure would not be funded through the Government budget and therefore, the SCITBs were promoted as a **means to circumvent the budget process**.

Mr. Speaker,

I have now outlined the circumstances around the raising of the finance and why it was unconstitutional. I would now like to discuss the fees and procurement processes.

Malco and Backwell Lombard Capital were to receive fees for arranging the financing and underwriting the issuance while National Capital Limited was to receive fees for acting as agent and managing the funds. Around K15 million or 12% of the issuance proceeds were to be spent on fees in the first year of the project. The Bank of Papua New Guinea have information which indicates that a further K10 million in fees would be payable to Malco over the life of the project.

Underwriting services are normally provided when it is uncertain whether there will be enough investors to buy all the securities on offer. However, in this case Nasfund was prepared to buy the whole amount on issue. In addition, the State was not having any difficulty raising funds through its normal Treasury Bill issuance and demand for Government Securities was high. Therefore the engagement of an underwriter and payment of underwriter fees was unnecessary.

Mr. Speaker.

Nasfund, in its e-Newsletter of April 2010, announced that they had purchased the K125 million of SCITBs. It stated that the overall aim of the investment was to provide infrastructure in an **accountable framework**. The newsletter indicates that Nasfund believed National Capital Limited would not pay invoices without examining tender documents and reviewing the work completed.

However, Mr Speaker, despite what Nasfund believed, this is not how the transactions have been conducted. Contracts were awarded by Malco. Instead of verifying tender processes, contracts and implementation of works, National Capital Limited generally just paid invoices which had been approved by Malco.

I can report that K56.5 million of invoices have been paid to the following contractors:

- Niugini Asset Management Ltd;
- Covec (PNG) Ltd;
- Kokopo Earthmoving Ltd ;
- JGBBE Consulting Engineers; and
- Golding HKG Ltd.

Covec and Golding HKG Limited are Chinese companies. Niugini Asset Management Limited was a company registered in PNG in October 2009. Its directors are Henry Lorimer and Peter Kakoa. Kokopo Earthmoving Ltd **is not** currently registered as a company in PNG. JGBBE Consulting Engineers was registered in PNG in 2005.

Governor for East New Britain raised a critical question on how the goods and services were procured. However, I have no information regarding how these companies were selected to undertake the work.

I understand that K55.2 million of the K125 million remains in a bank account held by National Capital Limited. The remaining K12.9 million has already been paid out in fees.

Mr. Speaker

This project was to be just the beginning in a line of similar schemes which would be highly lucrative for Malco, National Capital Ltd and other financial advisory firms.

It was planned that the Kokopo Infrastructure Project was to have a second tranche of K125 million and other infrastructure projects were to be funded through further tranches totaling K1.25 billion. Furthermore, the former Treasurer was approached by Malco to undertake similar schemes funding expenditure by the Border Development Authority both domestically and on overseas capital markets.

In October 2010, the Department of Treasury learned that the scheme's proponents had attempted to entice other investors to purchase SCITBs under a second tranche. The current prime Minister in his former role as a Treasurer, acted decisively to prevent this from occurring by releasing a Public Notice stating that only the Department of Treasury was authorized to issue Government Securities through their Agent, the Bank of PNG.

Mr. Speaker,

A notice was released to the Press with the former Prime Minister's signature in February 2011. The notice stated that the Department of Treasury confirmed that the SCITBs were issued on behalf of the State and that the Treasury Bills had been authorized by the Department. In addition, the contact details of a Treasury officer had been copied from the Treasurer's Notice and was added to this press release.

This statement was completely incorrect and released without the knowledge or consent of the Department of Treasury. The Department does not know who carried out this deception.

Mr. Speaker,

The State Solicitor advised further that, as the issuance of the SCITBs was illegal, the State has no obligation to repay Nasfund.

However, the Government does not want Nasfund members' losing their savings because the Nasfund Board and Management made a poor investment decision on the basis of incorrect legal advice and representations by Government Ministers and National Capital Limited.

Therefore, NEC has decided to reimburse Nasfund for any losses of principal invested in the SCITB. The Department of Treasury and State Solicitor are currently considering how this can be legally done through the budget.

I also want to inform this honourable house that I will be taking new submission to cabinet to advice on the corrective actions to take regarding this matter.

Mr. Speaker,

Finally, on 17 May 2011 the former Minister for Communication and Information Technology in his response to questions raised in Parliament likened the Kokopo SCITB financing to that of the Poreporena Freeway project (1995, 1996 and 1997). I want to say that the Poreporena Freeway project financing was not similar to that of Kokopo SCITB financing. It was a straight forward loan that was obtained from National Provident Fund (now NASFUND) and Defence Force Retirement Benefit Fund. This project was appropriated in the budget in 1995 and subsequent years until the loan was fully expended.

Thank you Mr. Speaker