The Treasury

South Canterbury Finance Limited Information Release

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(b)(i) - to protect trade secrets

[3] 9(2)(b)(ii) - to avoid unreasonable prejudice to the commercial position of the person who supplied the information or who is the subject of the information

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[5] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

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[7] 9(2)(h) - to maintain legal professional privilege

[8] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, an [8] appearing where information has been withheld in a release document refers to section 9(2)(i).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Guarantee schemes: FEC 17/06/2009

This briefing provides you with key messages, Q&A and background material to use if the issue of the guarantee schemes is raised at the FEC.

The retail deposit guarantee scheme was introduced to ensure continued depositor confidence in New Zealand given international financial market turbulence. The scheme is similar to those now offered by other countries, including Australia, and follows other measures that have been undertaken by the Reserve Bank to ensure the liquidity of the financial system.

The wholesale funding guarantee facility exists to enable New Zealand financial institutions to access wholesale funding markets in a risk-averse global environment where many other governments have offered guarantees on their banks' wholesale debt. The international market is a key channel through which New Zealand's substantial external financing needs are met.

Annex 1 provides you with an update on the status of entities in the retail and wholesale guarantee schemes, and Annex 2 provides you with a list of all institutions that are participating in the retail and wholesale guarantee schemes (from the Treasury website).

As you will be aware, Treasury has operational responsibility for the retail and wholesale deposit guarantee schemes. This involves:

- Processing and evaluating applications (to retail deposit guarantee scheme and the wholesale funding guarantee facility).
- Monitoring entities in the scheme.
- Ensuring payout/resolution processes are in place for eligible depositors in an event of default (e.g. when a firm is placed in receivership).

Treasury has also been providing Ministers with advice on policy related to the retail deposit guarantee scheme due to expire on 12 October 2010, including what if any arrangement might operate post October 2010. The Government has yet to take a decision on any policy changes, or indicate publicly when such a decision will be announced.

In responding to any FEC questions regarding the guarantee schemes, we suggest that you provide a high level outline of Treasury's operational role, but do not go into too much detail about particular entities or risks in the scheme, or possible future arrangements. We should not discuss any specific institutions.

Key messages

- We are actively monitoring risk in the schemes and managing these within the terms of the Deeds entered into with participating entities.
- The objectives of the schemes continues to be important (we shouldn't lose sight of this) – providing depositor confidence and banks with access to funding.
- We are carefully considering arrangements (if any) post October 2010. These issues are complex and significant. We are aware of the importance of signalling early to market to provide depositors and institutions with certainty.

Key issues (Q&As for each are provided below)

1. Managing Crown risk in the guarantee schemes.
2. Operation of the schemes.
3. Future arrangements.

Question and answers

1. Managing the Crown's risk in the guarantee schemes

Q: Do we expect other companies to fail?

A: We operate on the basis that institutions covered by the guarantee can fail. We are aware that some non-bank deposit takers are facing challenging business conditions in the current economic environment and are doing their best to work their way through it. While the Crown actively monitors financial institutions covered under the guarantee, it is not possible (and it would be wrong) to predict failures in relation to any specific financial institution.

Q: What is the current size of the Government contingent liability from the retail and wholesale guarantee schemes?

A: Retail guarantee scheme:
As at 9 June 2009, 91 financial institutions had joined the retail scheme with eligible deposits totalling $126 billion. This is the maximum exposure if all the institutions in the scheme were to fail and does not include any offset resulting from the recovery of the remaining assets of the financial institution in the event the guarantee is called upon.

Whole guarantee scheme:
As at 9 June 2009, an estimated total NZ$6 billion (NZ$285 million, US$4.25 billion and ¥23 billion) wholesale securities have been guaranteed by the Crown.

Q: Has the Crown's exposure increased since the inception of the schemes?

A: Under the retail scheme, the Crown's exposure has increased from $125 billion covering 40 institutions (as at 31 October 2008) to $126 billion covering 91 institutions (as at 30 April 2009).

The Crown's exposure in wholesale scheme increases with each new guaranteed security issuance.

Q: How has the Crown provisioned for the exposure?

A: Although calls on the guarantees remain a possibility, the Crown does not assess the likelihood of further defaults by any individual deposit-takers as being probable at this stage. Therefore no provision has been made beyond those entities that are currently in default, for which, a provision is included in the Government's financial statements.

The Crown has provisioned for both Mascot Finance and Strata Finance in line with the expected loss that the Crown expects to incur.

[If further detail is sought] *There is a "non quantified" fiscal risk currently in the Crown financial statements as a contingent liability as the Crown currently assesses the potential loss associated with the guaranteed entities as being in the range of $650 - $700 million under a liquidation scenario for all guaranteed non-bank deposit taking entities. The liquidation scenario assumes that all guaranteed non-bank deposit takers (NBDTs) default in isolation, but that default does not expose the Crown to a potential loss in all instances. This assessment of potential loss is in line with the original publicly released estimate in Treasury Report T2008/2017 in which the Crown assessed the potential loss associated with the guaranteed entities as being in the range of $462 - $945 million with a midpoint of $704 million.*

Q: How is the Crown's risk assessed from the firms guaranteed in the retail scheme?

A: The Trustees of the guaranteed NBDTs provide financial information to the RBNZ on a monthly basis. This information is analysed by the RBNZ and a monthly report is provided to the Treasury. Part of the RBNZ reporting includes an assessment of the relative riskiness of NBDTs.

The relative riskiness of an NBDT entity within the scheme is based on an assessment of the entity's risk associated with credit quality, liquidity and general business practices.

Q: How much fee income in total has the Crown received?

A: To date, fee income of $87 million has been received from the 91 institutions guaranteed under the retail deposit guarantee scheme.

Fee income of $134 million has been received from six eligibility certificates issued under the wholesale guarantee scheme.

Q: Does Treasury have the capability to deal with a large payout?

A: As you would expect, as part of prudent risk management practice, Treasury prepares for managing possible risks arising under the guarantee scheme.

Q: What tools does the Crown have to manage risk under the deposit guarantee scheme?

A: Treasury has the ability to:

- *prevent or to require the entity to remedy particular transactions such as distributions, material non-commercial transactions and related party transactions;*
- *remove the guarantee to limit potential future increases in the nominal exposure; and*
- *ensure appropriate contingency plans are in place to respond effectively to a default.*

These options are supported by the ability to request additional information from a range of sources and to appoint inspectors to investigate and report on any matters of concern. Also, the Crown has the power to replace a deed of guarantee with different terms provided it doesn't disadvantage depositors.

Q: Are the tools that are available to Crown sufficient to manage risk in the retail deposit guarantee scheme?

A: There are several tools available to manage risk in the retail deposit guarantee scheme. Treasury and the RBNZ are continuously monitoring the institutions guaranteed under the scheme and have taken appropriate actions where necessary.

Q: Have all the payments been made to eligible Mascot Finance and Strata Finance depositors? How long did it take?

A: This is an ongoing process.

ENTITIES IN DEFAULT	TOTAL EXPOSURE		CLAIMS PAID		CLIAMS REMAINING	
	$m	No of claims	$m	No of claims	$m	No of claims
Mascot Finance	69.1	2,700	40.1	1299	29	1401
Strata Finance	0.4	18	0.24	8	0.16	10

For Mascot Finance, currently 200+ payments (totalling $7m) are being processed per week by PricewaterhouseCoopers.

For Strata Finance, the claims process is being handled within the Deposit Guarantee Scheme Team in view of the limited number of depositors.

Q: Has the eligibility criteria changed after the defaults of Mascot Finance and Strata Finance?

A: No, institutions that meet the eligibility criteria and the relevant public interest test at the time of their application are granted access to the scheme (as before).

Q: What progress has been made on the review of Mascot Finance?

A: Treasury has undertaken to review the events around and the collapse of Mascot Finance in order to enhance Treasury's ability to anticipate operational risk and, in particular, to manage communication risk. The report to the Secretary of Treasury is to be finalised by mid/late June 2009 who will then make decisions on what further actions, if any, he will take.

Q: What progress has been made on the Commerce Committee review of finance companies and trustees?

A: This is an issue for the Select Committee to address.

The role of trustees will be considered as part of the review of the Securities Act recently announced by the Minister of Commerce (Hon Simon Power). This will provide an opportunity to consider whether the rules around issuing securities to the public remain robust. Questions on this review are best addressed to the Ministry of Economic Development.

2. Operations of the schemes

Q: Is additional conditionality being considered for access to the guarantees (e.g. employment, lending and mortgage holiday conditions)?

A: We would be very cautious about adding conditions to the guarantee as it risks undermining the guarantee's objectives.

The objective of the retail scheme is to provide confidence to depositors during this period of global financial market instability. The objective of the wholesale scheme is to enable New Zealand financial institutions to access wholesale funding markets in a risk-averse global environment.

Q: What is the status of Viaduct Capital?

A: The guarantee was withdrawn for new deposits in Viaduct Capital on 20 April 2009. Treasury is continuing to monitor Viaduct Capital as eligible depositors prior to 20 April are still guaranteed by the Crown.

Q: Is there a risk that the trustees of guaranteed institutions facing difficulties will decide to call in receivers rather than work on fixing their problems, as the government will pay out 100% to the depositors?

A: There is a possibility that the guarantee could incentivise this behaviour in certain situations. However, we have not observed this behaviour so far. Trustees and directors also need to act in the interest of non-eligible depositors who may not benefit from this strategy.

[If asked what actions Treasury is taking to mitigate this risk, you could say that we will continue to monitor behaviour, and assess options to mitigate this risk, if it arises.]

Q: Why didn't the Crown cover those depositors who lost their investments in the failed finance companies before the introduction of the retail deposit guarantee scheme?

A: The retail deposit guarantee scheme was introduced as a response to heightened worldwide financial market turbulence in October 2008. This was an extraordinary policy response required at a time of great uncertainty across financial markets. These concerns did not exist when previous finance companies failed.

Q: Why was the price of the wholesale guarantee reduced?

A: The wholesale funding guarantee facility exists to enable New Zealand financial institutions to access wholesale funding markets in a risk-averse global environment where many other governments have offered guarantees on their banks' wholesale debt.

The revision in prices is part of a regular review to take into account the changing market environment. The pricing schedule has been changed twice since the scheme was first announced in November 2008.

Q: Will Treasury approve non-banks to use the wholesale facility?
A. The facility is available to investment grade financial institutions with substantial New Zealand borrowing and lending operations. We have not ruled out approving non-banks use of the wholesale facility. Each application will need to be assessed on its merit, in light of the policy intent (to support the re-entry of New Zealand financial institutions into financial markets, on a scale commensurate with New Zealand's overall financing needs).

Q: Was the eligibility criteria for the retail scheme set correctly?

A: The scheme was introduced to provide confidence to depositors during this period of global financial market instability. Banks and NBDTs are eligible for the scheme. The decision to include banks, credit unions, building societies and finance companies was to maintain a deep and varied financial sector. However, parts of this sector were and continue to be in a process of adjustment, including NBDTs adjusting to new prudential requirements.

Excluding parts of the deposit taking sector from the retail scheme could have precipitated failure of otherwise sound firms, while including them in the retail scheme, means some fragile firms were also covered.

Q: Was the fee structure for the retail scheme set correctly?

A: The fee structure is that large banks do not pay fees on eligible deposits of less than of $5.0 billion, and pay a fee on eligible deposits over $5.0. Smaller institutions (less than $5.0 billion) are charged depending on their credit rating and growth of their deposit book. The fee schedule is provided below.

Rating	**Percentage**	**Fees paid by NBDTs on growth over 10%**
AA minus or higher	0.10%	Yes
A minus or higher (but lower than AA minus)	0.20%	Yes
BBB minus or higher (but lower than A minus)	0.50%	Yes
BB or higher (but lower than BBB minus)	1.00%	Yes
Unrated or lower than BB	3.00%	Fees paid on any growth

The scheme is provided to banks and non-bank institutions in order to provide confidence in these institutions. The scheme is offered to these financial institutions at a rate based on the risks of these institutions using credit rating as the means to differentiate.

Q: Would a change in the retail scheme fee structure help banks to reduce interest rates?

A: The scheme is offered to financial institutions participating in the retail scheme at a rate based on the risk profile (using credit ratings) of these institutions. As the amount of fees paid is unlikely to be a major cost for banks, reducing the fees is unlikely to result in lower interest rates.

All the banks in the scheme have "AA minus or higher" credit rating and pay fees of 10 basis points on the guaranteed deposits exceeding $5 billion.

Q: Are the stronger financial institutions (such as large banks) subsidising the smaller institutions (generally non-bank institutions)?

A: The amount of fees paid by smaller institutions is dependent on the credit rating of the institution and the extent to it grows. The differentiated pricing by credit rating allows the Treasury to charge fees based on the risk profile of the institution. Smaller institutions are charged fees if the growth per year of guaranteed deposits exceeds 10 percent (or on any growth, if they are not rated). This provides a disincentive to these institutions (generally non-bank institutions) to increase their customer base on the back of the guarantee alone. It also helps to mitigate the risk of a large scale shifting of capital between institutions in the sector covered by the scheme.

Q: In retrospect, were the retail and wholesale guarantee schemes needed?

A: The retail scheme was introduced to provide confidence to depositors during this period of global financial market instability. It seems to have achieved this objective, although the counterfactual is difficult to determine.

The wholesale funding guarantee facility was introduced to ensure that, if required, New Zealand banks can access the long term funding markets to secure funding necessary to carry out their normal business operations. The demand from the banks for the wholesale scheme probably indicates there was a need to introduce the wholesale funding guarantee facility.

These interventions are in line with interventions made by governments throughout the developed world in response to unprecedented financial market instability.

3. Future arrangements

Q: Will the deposit guarantee scheme be replaced or extended after 12 October 2010?

A: The government offered the retail deposit guarantee for a two-year term as a response to international financial market turbulence. This was to give time to see how well international financial markets stabilise. A thorough assessment of the ongoing need for, and design of, any future arrangements is being considered and decisions will be announced in due course.

The wholesale guarantee was introduced to support the access of New Zealand financial institutions into wholesale funding markets. Treasury is continuing to monitor, on an ongoing basis, whether the wholesale facility is needed.

Q: When will the announcement be made regarding the future of the deposit guarantee scheme?

A: The announcement regarding the future of the retail deposit guarantee scheme will be made in due course once options have been fully considered. We are aware of the importance of providing depositors and institutions with certainty.

Q: Are officials considering deposit insurance as an option after the expiry of the retail deposit guarantee scheme in 12 October 2010?

A: Deposit insurance is in place in many other countries (including every other OECD country). It is an option, but an assessment would need to be made as to whether it would be beneficial in the New Zealand case.

Q: What is Australia planning to do after the expiry of its retail deposit guarantee scheme? What implications will that have for New Zealand?

A: Australia has in place a financial claims scheme. Their scheme expires later than ours (October 2011). Australia had an arrangement in place before the introduction of enhanced guarantee arrangements in October 2008.

In terms of what Australia plans to do, this is an issue for Australian authorities to address. We maintain regular contact with our Australian counterparts on these and other Trans-Tasman issues.

We would not expect permanent arrangements in Australia (with a low limit) to have a major impact on New Zealand.

Q: Will new prudential regulation for non-bank deposit takers (NBDTs) cause firms to fail and crystallise losses to taxpayers?

A: The prudential regime will not directly cause failures. It is one of a number of challenges facing the sector, in addition to uncertainty about the retail deposit guarantee scheme and an adverse macroeconomic environment. It is possible that not all existing NBDTs will meet the new regulatory regime. Some entities may need to restructure their business, merge or exit the market.

The phase-in period of new regulation should allow businesses time to make decisions regarding the new regime. The new prudential regime should however serve to strengthen the position of many NBDTs making them less likely to fail under the guarantee or once the guarantee has been removed.

ANNEX 1: DEPOSIT GUARANTEE SCHEMES: STATUS AS AT 10 JUNE, 2009

Retail deposit guarantee scheme

- 91 deposit-takers have been entered into the Crown Deed of Guarantee covering retail deposits (12 banks, 8 building societies, 20 credit unions, 30 finance companies and 21 collective investment schemes). A list of these is included in annex 2.
- Guaranteed deposits total $126 billion (93 percent in banks and 7 percent in non-bank deposit taking institutions). However, it is very unlikely that a significant proportion of this will be called and, in the case an entity fails, it would be offset by the Crown's claim on the remaining assets of the entity.
- Guarantee fees totalling $87 million have been collected. Most of this relates to fees paid by the larger (>$5 billion deposits) institutions, which have paid an annual fee based on their total deposits. Smaller institutions pay a monthly fee based on their deposit growth and credit rating.
- Two defaults events have occurred under the scheme:
  - Mascot Finance (2 March 2009) – default, receivership and payout, approx $69m eligible deposits, 2,700 depositors.
  - Strata Finance (16 April 2009) – default and payout, approx $0.4 million eligible deposits, 18 depositors.
- The guarantee has also been withdrawn for new deposits in Viaduct Capital (20 April 2009) because the Crown reasonably considered that the business or affairs of Viaduct were being, or were intended or likely to be, carried on in a manner which may extend the effective benefit of the Crown guarantee to persons who are not intended to receive that benefit; and was otherwise inconsistent with the intentions of the Crown in entering into the guarantee.

Wholesale deposit guarantee scheme

- The Crown has signed a wholesale funding guarantee deed in respect of the following institutions: ANZ National Bank Limited, Bank of New Zealand, Westpac New Zealand Limited and Kiwibank Limited.
- Six Eligibility Certificates has been issued totalling NZ$285 million, US$4.25 billion and ¥23 billion – [3]

ANNEX 2: LIST OF INSTITUTIONS PARTICIPATING IN CROWN GUARANTEE SCHEMES: STATUS AS AT 10 JUNE 2009

Retail deposit guarantee scheme

The below is a list of institutions that are participating in the Crown retail deposit guarantee scheme and that have signed Crown deeds of guarantee or Crown deeds of nomination.

- ABN AMRO Craigs Cash Management Trust Limited
- Allied Nationwide Finance Limited
- ANZ Call Fund
- ANZ National Bank Limited
- ANZ Term Fund
- Aotearoa Credit Union

- ASB Bank Limited
- ASB Cash Fund
- ASB Term Fund
- Asset Finance Limited
- Avanti Finance Limited
- Bank of New Zealand
- BNZ Cash PIE
- Broadlands Finance Limited
- Business Finance Limited
- Canterbury Building Society
- Cash Advantage Fund
- Caxton Employees Credit Union
- Christchurch Emergency Services Credit Union
- Citibank, N.A. - New Zealand Branch
- Client Reserve Limited
- Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. (New Zealand Branch)
- Credit Union Auckland
- Credit Union Baywide
- Credit Union Central
- Credit Union Lakeland
- Credit Union North
- Credit Union South
- Direct Broking Call Account
- Diversified Cash Portfolio
- Equitable Mortgages Limited
- FAI Finance Limited
- Farmers' Mutual Finance Limited
- FE Investments Limited
- Finance Direct Limited
- First Credit Union
- Fisher & Paykel Credit Union
- Fisher & Paykel Finance Limited
- Forsyth Barr Cash Management Trust
- General Finance Limited
- Gold Band Finance Limited
- Hastings Building Society
- Heretaunga Building Society
- HSBC Cash Fund
- HSBC Term Fund
- Kiwibank Limited
- Kiwibank PIE Online Call Fund
- Kiwibank PIE Term Deposit Fund
- Kookmin Bank (New Zealand Branch)
- Lifestages Deposit Portfolio
- MARAC Finance Limited
- Marsden Point Refinery Credit Union
- Medical Securities Limited
- Money Market Portfolio (formerly Money Market Trust)
- Mutual Credit Finance Limited
- Mutual Finance Limited

- National Bank Call Fund
- National Bank Private Banking Call Fund
- National Bank Term Fund
- Nelson Building Society
- New Zealand Employees Credit Union
- New Zealand Firefighters Credit Union
- NZF Money Limited
- Oxford Finance Corporation Limited
- PGG Wrightson Finance Limited
- Police and Families Credit Union
- Private Banking Portfolio Call Fund
- Prometheus Finance Limited
- PSIS Limited
- Rabobank New Zealand Limited
- Rockforte Finance Limited
- Savings & Loans Limited
- South Canterbury Finance Limited
- Southern Cross Building Society
- Southland Building Society
- Steelsands Credit Union
- The Hongkong and Shanghai Banking Corporation Limited (New Zealand Branch)
- The Napier Building Society
- Thoroughbred Cash Fund
- TSB Bank Limited
- TSB Bank PIE Cash Fund
- UDC Finance
- United Credit Union
- UT34
- Vision Securities Limited
- Wairarapa Building Society
- Wellington District Manchester Unity Credit Union
- Westforce Credit Union
- Westpac New Zealand Limited
- Wilson & Horton Employees Credit Union
- Wine Country Credit Union

Wholesale funding guarantee facility

The Crown has signed a wholesale funding guarantee deed in respect of the following institutions: ANZ National Bank Limited, Bank of New Zealand, Westpac New Zealand Limited and Kiwibank Limited.