

The Treasury

South Canterbury Finance Limited Information Release

Release Document

April 2011

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Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

- [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
- [4] 9(2)(ba) - to protect information that is subject to an obligation of confidence, or that was or could be provided under legal compulsion, where making the information available would be likely to prejudice the supply of similar information and it is in the public interest for that information to continue to be supplied
- [5] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
- [6] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [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.

Date: 6 October 2009

To: Struan Little

Cc: Jeremy Corban
Joanna Gordon
Brian McCulloch

From: John Park
Craig Murphy
Maureen Tong

INSPECTIONS

A total of six inspections have been instructed, with a total budget of \$1.525m, and we are expected to spend \$1.390m.

The total budget of \$1.525m was an indicative initial estimate of what the inspection were to cost. The complicating factors include the level of detail we had on the entities prior to the inspection to enable an accurate estimate of costs to be estimated.

The costs of undertaking the inspections is fair in my opinion, and the competitive tension of future work is a strong incentive not to overcharge the Crown. In addition, Korda Mentha and PriceWaterhouseCoopers have offered discounted fees for the second and subsequent inspections that they have undertaken.

Inspector	Company	Budget	Spent	Invoice	Cost to Complete	Total	Surplus/Shortfall
PriceWaterhouseCoopers	[3]	[3]	-	[3]	[3]		
PriceWaterhouseCoopers			-				
Korda Mentha	Equitable Mortgages Limited		-				
Korda Mentha	South Canterbury Finance Limited		-				
Korda Mentha	Allied Nationwide Finance Limited		-				
Deloitte	Vision Securities Limited		-				
		1,525,000.00	-	860,934.39	530,000.00	1,390,934.39	134,065.61

While the South Canterbury Finance Limited inspection is significantly over budget, with all six inspections considered we are expected to be slightly under budget.

The outcomes of the inspections have met the objectives that we set. We now have very detailed information on the six inspected entities in regard to their asset quality, liquidity and general management practices. In addition, we have key risk areas which we will monitor going forward as part of our monthly monitoring reporting.

It is recommended that we review the best way forward in regard to monthly reporting to ensure that we are effectively monitoring the high risk entities, options that could be considered include:

1. Treasury setting up standing orders for additional information from high risk entities;
2. using existing Treasury Staff in a "Relationship Manager" type role for increased monitoring of high risk entities;
3. increased use of the RBNZ monitoring of high risk entities; and
4. continued use of inspectors for detailed monthly reporting of high risk entities.

KORDA MENTHA INSPECTIONS

Korda Mentha has conducted three inspections:

1. South Canterbury Finance Limited;
2. Equitable Mortgages Limited; and
3. Allied Nationwide Finance Limited.

Inspector	Company	Budget	Spent	Invoice	Cost to Complete	Total	Surplus/Shortfall
Korda Mentha	Equitable Mortgages Limited	[3]					
Korda Mentha	South Canterbury Finance Limited						
Korda Mentha	Allied Nationwide Finance Limited						

2

The budget that was set for the inspections was prior to the scope of work that was set and was included on the basis of an internal “best guess” estimate. The quote from Korda Mentha of [3] was in excess of the initial [3] estimate of cost, and the cost is in line with their estimate.

[6]

South Canterbury Finance Limited (“SCF”)

SCF is the largest finance company in New Zealand with a total lending book of \$1,687m and a Crown Guaranteed deposit book of \$1,855m covering in excess of 40,000 depositors.

The inspection of SCF has been completed by Korda Mentha, and the final report has been issued.

Based on the Korda Mentha inspection report, and other information sources it is considered probable that SCF will default under the existing Crown Guarantee and therefore a provision of \$667m has been provided for in the Crown accounts.

To date, the Treasury has been billed for [3] in “Inspection Services” under two invoices. In addition, we are expecting an additional [3] to be billed in the month of October. In total, the cost overrun on the SCF inspection is expected to be [3] or circa 60% of the initial budget of [3]. The costs associated with the inspection of SCF are covered by PLA.

The key reasons that the inspection has gone over the initial estimate of costs are:

- SCF was in far worse state than what was anticipated, and Korda Mentha was required to do significantly more work to provide the information requested in our instruction letter;
- our report had a widening scope. Korda Mentha have taken direction from Treasury outside of the original scope document as more people got involved in the inspection. The type of additional work undertaken included, but was not limited to;
 - Discussion and monitoring around the various “rescue” packages that have been put together;
 - Sell down of assets; and
 - Discussion around potential receivership processes.

Equitable Mortgages Limited (“Equitable”)

EML is a second tier property lender specialising in first mortgage finance (max LVR 66.6%). EML has a book of \$252m, made up of 55 loans to 28 borrowers, which is funded in part by a Crown Guaranteed deposit book of \$156m covering in excess of 4,800 depositors.

The inspection for Equitable has been completed, and the final report has been issued.

Based on the Korda Mentha inspection report, and other information sources it is not considered probable that Equitable will default under the existing Crown Guarantee and therefore no provision has been made in regard to Equitable.

To date, the Treasury has been billed for [3] in “Inspection Services” under one invoice. In addition, we are expecting an additional [3] to be billed in the month of October. The inspection for Equitable is expected to come in [3] under the initial budget of [3]. The costs associated with the inspection of Equitable are covered by PLA.

Allied Nationwide Finance Limited (“Allied”)

Allied is a second tier diversified finance provider. Allied has a Crown Guaranteed deposit book of \$208m covering in excess of 6,600 depositors.

The inspection for Allied has been completed, but the final report is due to be issued by the 9th of October. There has been significant issues associated with the quality of the information that Allied has provided to Korda Mentha which has meant that there has been a considerable delay in receiving this report.

Based on initial feedback from Korda Mentha other information sources it is not considered probable that Allied will default under the existing Crown Guarantee and therefore no provision has been made in regard to Allied. However, this may change on receipt of the inspection report.

To date, the Treasury has not been billed for “Inspection Services”, but due to the significant amount of work that Korda Mentha have had to do in regard to this inspection due to incomplete information we are expecting [3] to be billed in the month of October, and that the inspect is on budget. The costs associated with the inspection of Allied are covered by PLA.

PRICEWATERHOUSECOOPERS

PriceWaterhouseCoopers has conducted two inspections:

- 1. [3]
- 2.

Inspector	Company	Budget	Spent	Invoice	Cost to Complete	Total	Surplus/Shortfall
[3]							

[6]

[3]

To date, the Treasury has been billed for [3] in "Inspection Services" under two invoices. In addition, we are expecting an additional [3] to be billed in the month of October. In total, the cost overrun on the [3] inspection is expected to be [3] or circa 12% of the initial budget of [3] due to the continual movement and assessment of management around the potential capital structure of [3] / the [3] and the complex nature of the transaction. The costs associated with the inspection of [3] are covered by PLA.

[3]

DELOITTE

Deloitte has conducted one inspection, Vision Securities Limited.

Inspector	Company	Budget	Spent	Invoice	Cost to Complete	Total	Surplus/Shortfall
Deloitte	Vision Securities Limited	[3]					

[6]

Vision Securities Limited ("VSL")

VSL is a mezzanine property finance lender and has a book of \$34.3m, made up of 16 loans. SCBS has a Crown Guaranteed deposit book of \$37m covering in excess of 1,100 depositors.

The inspection for VSL is close to completion. The main inspection is completed, and update report focused on external valuations has been supplied in draft for our comment.

To date, the Treasury has not been billed for "Inspection Services", but due to the significant amount of work that Deloitte have had to do in regard to this inspection due to incomplete information we are expecting [3] to be billed in the month of October, and that the inspect is well under budget. The costs associated with the inspection of VSL are covered by PLA.

Way Forward

Once the monthly accruals are completed, an updated expenditure report (on a cost to complete basis) will be circulated. This report will include any subsequent inspections and monthly monitoring by inspectors if required.

Before the next inspection is undertaken the RFP process will be completed, and where possible work will be tendered - we should not be undertaking inspections with the urgency that was required for the six entities where inspections have taken place.

We now have better information on what an inspection to our scope costs, and any further inspections are expected to have lower costs as we have inspected the material high risk entities, so any further inspection should be less risky and therefore cost less.

Acknowledgement

I note the cost overruns in regard to the inspections of [3] [redacted] and South Canterbury Finance Limited, and authorise the payment of the invoices related to the [3] [redacted], South Canterbury Finance, Equitable Finance Limited and [3] [redacted] inspections.

Struan Little
Acting Deputy Secretary