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.

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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

[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.

RECOMMENDATION FOR RETAIL DEPOSIT SCHEME PROVISION

For the Month Ending December 2009

Agreed by the Treasury DGS Provisioning Committee on 13 January 2009
Prepared by Craig Murphy, Senior Analyst, DGS Team, The Treasury

CONTENTS

1. PROVISION RECOMMENDATION

The quantum of the provision recommended for December 2009 is $776m.

The provisioning recommendation for December of $776m represents a decrease of $96m from the November 2009 provision of $872m agreed at the Treasury DGS Provisioning Committee on 11 November 2009. The number of entities covered by the provision is recommended to reduce from 9 to 7.

The recommended provision of $776m represents approximately 8.98% of the $8,644m in deposits guaranteed by the Retail Deposit Guaranteed Scheme (the "RDGS"), and effects approximarly 42,557 depositors of the 498,620 depositors (or 8.54%) covered by the RDGS.

Although the provision recommendation is for the month of December 2009, the base RBNZ information is dated 30 October 2009. However, this information is supplemented by current information held by Treasury where required.

The provision is made up of three key components:

1. the Crowns share of the **loss given default** of $575m, which has increased by $22m ($553m to $575m);
2. the estimated cost of **post acceleration interest of** $161m, which has decreased by $92m ($253m to $161m]; and
3. the **net effect of discounting** cash flows of $40m, which has decreased by $26m ($66m to $40m).

The table below provides an elemental break down of the provisioning recommendation for December 2009.

Entity Name	Risk Ranking Measures				Guaranteed		Loss Given Default Calculations			Estimated Failure Parameters	
	Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Depositors #	Deposits $m	Estimated Crown Loss	Post Acceleration Interest	Total Crown Loss	Date of Failure	Reason for Failure
South Canterbury Finance Limited	1.2	29	1.6	1.8	40,000	1,746	533	154	687	Jun-10	Equity, Liquidity
Vision Securities Limited	2.0	100	20.5	6.1	1,143	35	27	3	30	Jan - Mar 10	Equity, Liquidity
Viaduct Capital Limited	0.3	62	18.6	3.5	188	12	6	1	7	Jan - Mar 10	Equity, Liquidity
											[3]
Mutual Finance Limited	1.3	48	6.9	13.1	280	5	1	0	1	Jan - Mar 10	Equity, Liquidity
											[3]
	Sub Total				**42,557**	**1,833**	**575**	**161**	**736**		
	Plus Nett Effect of Discounting								**40**		
	Total Crown Loss / Provision Reconmendation								**776**		

Notes
[1]Liquid assets + short term asset maturities + committed facilities as a multiple to short term liability maturities
[2]Impaired + past due + 75% Cap Interest + 50% restructured loans as a percentage of total loans
[3]Net margin: Annualised net-interest-income + Fee Income to gross loans
[4]Capital ratio methodology utilising the proposed capital framework for NBDTs

2. OUTLINE OF SIGNIFICANT CHANGES

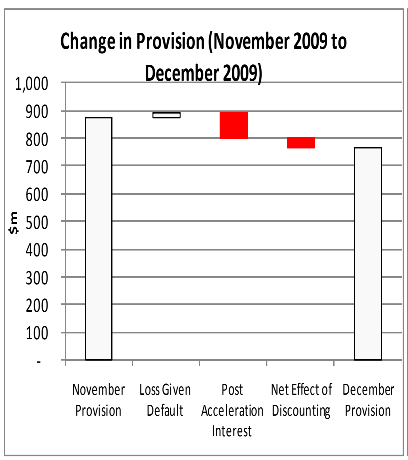
Key Changes

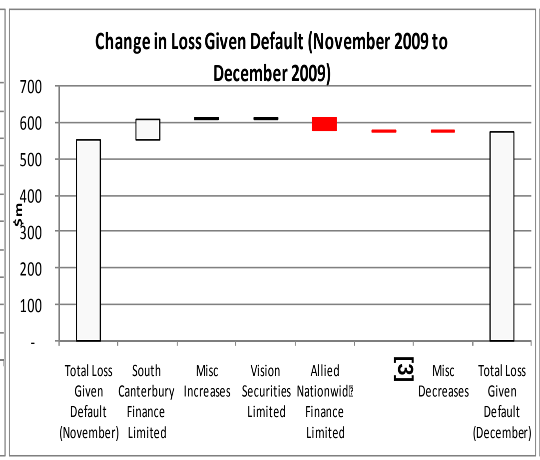
The provisioning recommendation for December 2009 of $776m represents a decrease of $96m from the November 2009 provision of $872m. The drivers of this decrease are an increase of $22m in the **loss given default**, a decrease in **post acceleration interest** of $92m, and a decrease in the **net effect of discounting** of $26m.

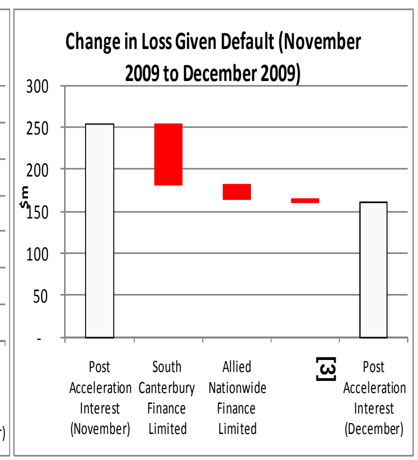
The Crowns share of the **loss given default** of $575m has increased by $22m ($553m to $575m). The major driver of the increase in loss given default is the increase in South Canterbury Finance Limited's ("SCF") loss given default, which has increased by $55m due to total assets reducing faster than total liabilities. The significant increase in loss given default from SCF is reduced by the removal of Allied Nationwide Finance Limited ("ANF") from the provision. ANF is to be removed from the provision as ANF parent (Allied Farmers) has received a $7m equity (cash) injection from [3] which is to be applied to ANF, in addition, the approval process for the $400m in equity injection from Hanover investors to Allied Farmers has been approved. $40m to $50m of the equity injection is to be provided to ANF (by way of the high quality loans). The result of the above is that ANF will be very well capitalised and short term liquidity will be robust.

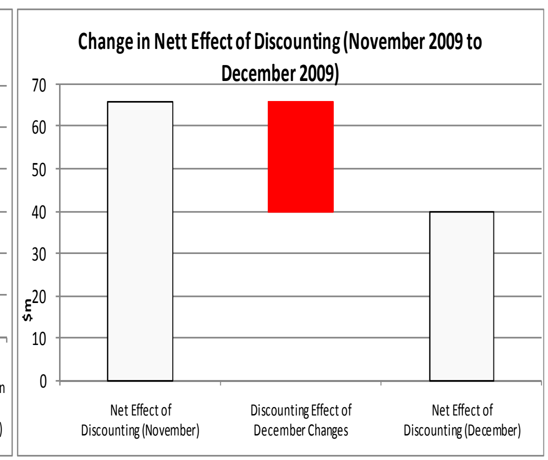
The estimated cost of **post acceleration interest** of $161m has decreased by $92m ($253m to $161m). The shortening of the average maturity period for SCF from circa 40 months to circa 12 months (due to a change in the way SCF reported it maturity profile – from average deposit duration to duration to maturity) and the removal of [3] from the provision for December 2009.

The **net effect of discounting** cash flows of $40m has decreased by $26m ($66m to $40m). The major drivers of the decrease are the changes that have occurred in the loss given default and post acceleration interest calculations. In addition, there have been minor changes to the net effect of discounting inputs. SCF's expected date of default has increased by 3 months, and other provisioned entities expected date of default has increased by 1 month.



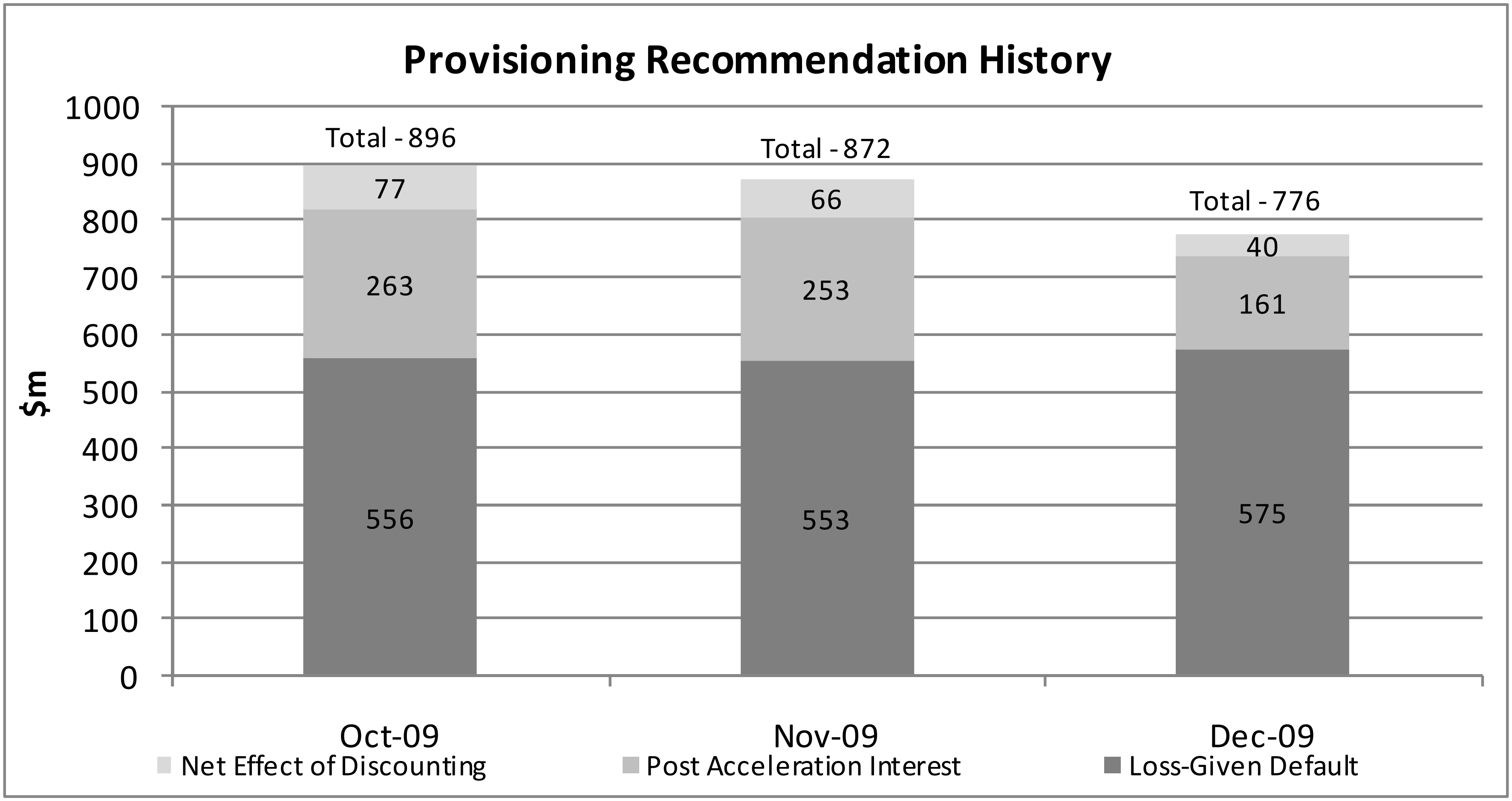






A red bar indicates a reduction.

3. OUTLINE OF HISTORICAL PROVISIONING RECOMMENDATIONS



	Oct-09	Nov-09	Dec-09
Loss-Given Default	556	553	575
Post Acceleration Interest	263	253	161
Net Effect of Discounting	77	66	40
Provision Recommended	896	872	776

4. PROVISION – LOSS GIVEN DEFAULT OUTLINE

Entity Name - South Canterbury Finance (SCF)
Credit Rating - BB+ Negative Outlook
DGS Status - Amend and replace complete / Have not applied for extension.
Expected Date of Failure - June-10
Expected Reason for Failure - Liquidity / Credit Quality

Background

SCF is the largest finance company in New Zealand with a total lending book of circa $1,600m and a Crown Guaranteed deposit book of circa $1,700m covering in excess of 40,000 depositors.

December Update

SCF, Helicopters, and Scales are now joined under the umbrella of a new parent holding company, Southbury. Southbury has also completed a private placement of $27.5 million of convertible notes as the first part of a two stage capital raising process.

Sandy Maier has assumed the role of CEO. Mr. Maier has been contracted by SCF's parent company, (Southbury), under a consultancy arrangement which sees him assuming the role of Group CEO and CEO of SCF.

Standard & Poor's affirmed its BB+ long term rating and removed it from CreditWatch Negative, where it was placed on September 20, 2009. The outlook is negative.

SCF's loss given default has increased by $55m due to total assets reducing faster than total liabilities, thereby creating an increased loss to the Crown upon failure.

Issues

The outstanding key issues SCF needs to address include:

1. Low levels of capital
2. High level of related party lending;
3. Deteriorating loan quality;
4. Concentration and large exposure risk;
5. Modest levels of provisions;
6. No bank support;
8. No risk grading on a significant portion of its book;
9. USPP has been accelerated – funded by a super senior short term loan;

$75m in SCF (as a prior ranking charge) lent to SCF in November 2009 by the Torchlight Credit Fund LP ("Torchlight") associated with [3] has enabled the part repayment of the USPP with the remainder scheduled to be progressively repaid over the next five months this has been reflected in the Total Crown Loss figure below.

Although progress is being made, significant liquidity, asset quality and equity issues lead to the conclusion that it is probable that SCF will default under the existing Crown Guarantee in or around March 2010.

Recommendation

Based upon the information held by Treasury and the issues outlined above, it is considered probable that SCF will default under the existing Crown Guarantee and therefore a provision is required.

The quantum of the provision recommended (exclusive of the net effect of discounting cash flows) is $687m, being the Crown's Share of the loss given default of $533m plus an allowance for post acceleration interest of $154m.

Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Month	Amount DGS	Non Gteed Deposits	Other Liabilities	Total Liabilities	Other assets	Cash & Liquid Assets	Net Loan Book	Total Assets	Loss-Given Default	Crown Loss-Given Default	Post Acceleration Interest	Provision Recommended
1.2	29	1.6	1.8	27,648	December	1,746	159	13	1,918	107	28	1,221	1,355	563	533	154	687
2	29	2.4	2.6	28,429	November	1,790	148	18	1,955	107	47	1,280	1,433	522	478	227	705
6	26	2.7	2.3	29,606	October	1,832	151	28	2,011	110	90	1,304	1,504	507	480	236	716

Notes
[1](Dec - Liquid assets + short term asset maturities + committed facilities as a multiple to short term liability maturities) (Oct to Nov - Liquid assets + 50% committed facilities as a percentage of guaranteed deposits)
[2]Impaired + past due + 75% Cap Interest + 50% restructured loans as a percentage of total loans
[3]Net margin: Annualised net-interest-income + Fee Income to gross loans
[4]Capital ratio methodology utilising the proposed capital framework for NBDTs

4. PROVISION – LOSS GIVEN DEFAULT OUTLINE

Entity Name – Vision Securities Limited (VSL)
Credit Rating – B (not announced to the market)
DGS Status - Amend and Replace Complete / Have not applied for extension.
Expected Date of Failure - Mar-10
Expected Reason for Failure - Liquidity / Credit Quality

Background

VSL is a small mezzanine finance company in New Zealand with a total lending book of circa $37m made up of approximately 16 loans and a Crown Guaranteed deposit book of circa $35m covering in excess of 200 depositors.

December Update

Vision has finalised its half year accounts (to 30 Sept 09). Total collective and specific provisioning will be $6.98m. This results in a breach of the capital adequacy provision within the Trust Deed. Perpetual Trust (visions Trustee) gave VSL formal notice of the capital adequacy breach on 15 December 2009 – however Perpetual Trust has agreed, subject to certain conditions, to waive the breach until 31 January 2010 to give Vision time to pursue a recapitalisation proposal.

Vision have proposed a recapitalisation proposal which involves the purchase of shares in the related party Vision Senior Living and participation in a right issue which would see between $0.5m and $2.2m in cash paid out, and no guarantee that the share can be on sold at a profit as required to "recapitalize" Vision as the proposal indicates.

A letter has been written to Vision outlining Treasury concerns with the proposed recapitilisation.

Issues

The outstanding key issues VSL needs to address include:

1. Negative equity, recapitalisation required;
2. Lending mostly subordinated, postponed second mortgages over development properties (Nominal cash flow from book);
3. Circa $8m cash balance being used$0.300m to $0.500m per month through operating costs and the payment of first mortgagee interest
4. $24.5 million (65.8%) of VSL's secured debenture stock is due to mature before October 2010.
5. Some related party lending;
6. Loan quality is deteriorating – book is essentially illiquid;
7. No bank support;
8. Standard and Poor's rated at B – not eligible for an extension.
9. No prospectus on issue.

Although progress is being made, significant liquidity, asset quality and equity issues lead to the conclusion that it is probable that VSL will default under the existing Crown Guarantee in or around March 2010.

Recommendation

Based upon the information held by Treasury and the issues outlined above, it is considered probable that VSL will default under the existing Crown Guarantee and therefore a provision is required.

The quantum of the provision recommended (exclusive of the net effect of discounting cash flows) is $30m, being the Crown's Share of the loss given default of $27m plus an allowance for post acceleration interest of $3m.

Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Month	Amount DGS	Non Gteed Deposits	Other Liabilities	Total Liabilities	Other assets	Cash & Liquid Assets	Net Loan Book	Total Assets	Loss-Given Default	Crown Loss-Given Default	Post Acceleration Interest	Provision Recommended
2.0	100	20.5	6.1	1,143	December	35	-	4	39	0	8	1	9	30	27	3	30
30	100	20.2	6.6	1,166	November	36	-	3	40	0	11	1	12	28	25	3	28
33	78	4.8	5.4	1,170	October	36	-	3	40	0	12	0	12	27	25	3	28

Notes
[1](Dec - Liquid assets + short term asset maturities + committed facilities as a multiple to short term liability maturities) (Oct to Nov - Liquid assets + 50% committed facilities as a percentage of guaranteed deposits)
[2]Impaired + past due + 75% Cap Interest + 50% restructured loans as a percentage of total loans
[3]Net margin: Annualised net-interest-income + Fee Income to gross loans
[4]Capital ratio methodology utilising the proposed capital framework for NBDTs

4. PROVISION – LOSS GIVEN DEFAULT OUTLINE

All 5 of these entities are ranked either high (4) or medium (1) risk by the RBNZ and due to significant concerns in regard to the liquidity, credit quality or capital it is recommended that these entities are provisioned for.

All 5 of these entities were provisioned for last month.

		Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Guaranteed Deposits $m	Estimated Loss-Given Default	Post Acceleration Interest	Total Crown Loss
Provisioned For										
Entity	Viaduct Capital Limited	0.3	62	18.6	3.5	188	12	6	1	7

Entity Type	Finance Company
Status (Last Month/This Month)	Provisioned For/Provisioned For
Expected Date of Faliure	Jan - Mar 10
Expected Reason For Failure	Equity, Liquidity
Relative Riskiness	
Credit Rating	Not rated
Amend and Replace Status	Not eligible
Extended DGS Status	Not eligible

Treasury had significant contact with Viaduct during the removal of the guarantee, now contact is of a compliance nature. Nick Weavers has been replaced as CEO. Guarantee was withdrawn from Viaduct on the 20th of April 2009 as the benefit of the Guarantee was being past to those not intended to receive a benefit. Loan assets are predominantly property development, and impaired. Very limited liquidity, very limited capital, expected to have trouble with next prospectus issue, audit round and payment of depositors as investment mature. Based upon the information held by Treasury and the issues outlined above, it is considered probable that Viaduct will default under the existing Crown Guarantee and therefore a provision is required. The quantum of the provision recommended (exclusive of the net effect of discounting cash flows) is $7m, being the Crown's Share of the loss given default of $6m plus an allowance for post acceleration interest of $1m.

[3]

4. PROVISION – LOSS GIVEN DEFAULT OUTLINE

		Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Guaranteed Deposits $m	Estimated Loss-Given Default	Post Acceleration Interest	Total Crown Loss
Provisioned For										
Entity	Mutual Finance Limited	1.3	48	6.9	13.1	280	5	1	-	1

Entity Type	Finance Company
Status (Last Month/This Month)	Provisioned For/Provisioned For
Expected Date of Faliure	Jan - Mar 10
Expected Reason For Failure	Equity, Liquidity
Relative Riskiness	
Credit Rating	Not rated
Amend and Replace Status	Completed
Extended DGS Status	Not applied

Treasury's contact with Mutual to date has been is of a compliance nature. Paul Bublitz (Hunter Capital) has purchased a 50% stake in Mutual, and Treasury has had correspondence around this with Mutual. Loan book includes predominantly property based with some consumer lending however loan quality is below average. Limited liquidity, well capitalised but expected to have trouble with next prospectus issue, audit round and payment of depositors as investment mature. Based upon the information held by Treasury and the issues outlined above, it is considered probable that Mutual will default under the existing Crown Guarantee and therefore a provision is required. The quantum of the provision recommended (exclusive of the net effect of discounting cash flows) is $1m, being the Crown's Share of the loss given default of $1m plus an allowance for post acceleration interest of $1m.

[3]

5. PROVISION – POST ACCELERATION INTEREST & DISCOUNTING

Cash flow projections for Investor Payout (including post acceleration interest) and Receiver Distributions

Cash flow forecasts are produced to enable the DMO to plan for the Crown to meet its cash obligations under the Guarantee Scheme, to inform the calculation of post acceleration interest liabilities for defaulting entities and to enable the provision for loss given default to be stated on a net present value basis. The process of forecasting cash flows is necessarily based on a number of assumptions in recognition of the significant uncertainties involved. This paper sets out the assumptions which underpin the forecast for the approval of the provisioning committee.

Investor Payout & Receiver Distribution Assumptions

The particular variables on which assumptions must be made are set out below:

Variable	Assumption
Which entities will default	The cash flow projection is based on the default of the entities for which provision has been made in the Oct accounts
The timing of any default	Default timing is based on key known triggers identified in provisioning papers – for instance, credit downgrades, liquidity walls, inability to renew prospectuses. Directors are likely to prompt a default in anticipation of the liquidity wall.
The claiming pattern of investors	As the Crown cannot impel investors to make a claim and investors are likely to be eligible for post acceleration interest it is likely investors will fall into three categories - those who need the money immediately and will put in a claim early, - those who will claim when their investment was due to mature (as this was when they expected the money), and - those who will hold off claiming in the interest of continuing to earn high interest rates. The early claimers are expected to net off against the late claimers and thus on average the maturity profile of the entity is the best indicator of claiming pattern. The actual maturity profile of SCF was used and for other entities a normal distribution around the average maturity date (with a 5% tail) was used.
The amount of distribution from receivers	The loss given default per entity has already been calculated for provisioning. This includes the cost of receivership. Therefore the receiver payout is assumed to be the gross amount paid out by Treasury less the loss given default.
The timing of distributions	For most entities the distribution pattern for National finance has been used as the model – the distribution took 3 years with the final payment being about 20% of the total. In SCF's case advice on big receiverships ($1b) was sourced from PWC who advised that the total process could take 6 years, distribution was thus assumed to be spread evenly over the 5 years subsequent to default. In Vision's case the distribution is assumed to be over a shorter period due to the fact that most assets are already in cash.
Discounted cash flows	Cash flows of both payout to investors and distributions from receiverships have been discounted to present value using GSF discounting rates. The net effect is to increase the anticipated loss given default by $76m, due to the extended timeframe for distribution from receiverships exceeding the benefit gained from the spread of the timing of payout.

Departmental costs of Administering the Guarantees

In addition to the actual Crown cash flows for investor monies paid out and receiver distributions, there are likely to be some additional costs incurred for risk monitoring/management and for managing the payout process itself. These costs would be covered by the PLA. These costs are estimated at a further $2.25m for investigations and $10m for payout which is allocated across the years based on the payout pattern.

5. PROVISION – POST ACCELERATION INTEREST & DISCOUNTING

Timing Assumptions

The table below illustrates that projected cash flows for payouts and distributions from receiverships.

Company Name (credit rating if available)	Default assumptions as at	Likely Timing For default	Average Maturity (months) from RB reporting for entities as at Oct bal date	Month of Average Maturity	Timeframe of % paid out by year: 2009/10 %	2010/11 %	2011/12 %	2012/13 %	2013/14 %	Proportion of receiver payout per year: 2010/11 %	2011/12 %	2012/13 %	2013/14 %	2014/15 %
South Canterbury Finance Limited	Half year accounts, credit rating downgrade	Jun-10	12	Nov-2010		66%	20%	12%	2%	20%	20%	20%	20%	20%
Vision Securities Limited	Liquidity, default imminent	Jan-10	13	Dec-10	20%	65%	5%			80%	20%			
[3]	Weak credit/ fail to renew prospectus from Dec to Feb	Feb-10	9	Jul-10	40%	55%	5%			40%	40%	20%		
Mutual Finance Limited					40%	55%	5%			40%	40%	20%		
[3]					40%	55%	5%			40%	40%	20%		
Viaduct Capital Limited					40%	55%	5%			40%	40%	20%		
[3]					40%	55%	5%			40%	40%	20%		

Cashflows per annum calculated / Gross cashflows

Company Name (credit rating if available)	Total to be paid out incl interest $m	Expected amounts from receivership $m	Treasury Estimated loss-given default $m
South Canterbury Finance Limited	1,900	1,213	687
Vision Securities Limited	39	8	30
			[3]
Mutual Finance Limited	6	4	1
			[3]
Viaduct Capital Limited	13	6	7
			[3]
Total cash flow	1,994	1,258	736
Net Present value of cashflows	1,851	1,074	
Discount (benefit)/cost	(143)	184	40
Loss Given Default post discounting			776

	Payout per year: 2009/10 $m	2010/11 $m	2011/12 $m	2012/13 $m	2013/14 $m	Receiver Distributions per year: 2010/11 $m	2011/12 $m	2012/13 $m	2013/14 $m	2014/15 %
South Canterbury Finance Limited	-	1,201	395	257	47	243	243	243	243	243
Vision Securities Limited	7	26	2	-	-	6	2	-	-	-
Mutual Finance Limited	2	3	0	-	-	2	2	1	-	-
Viaduct Capital Limited	5	7	1	-	-	2	2	1	-	-
Total cash flow	28	1,258	400	257	47	264	259	250	243	243
Net Present value of cashflows	28	1,206	361	218	37	253	234	212	194	182

6. WATCH LIST

Watch List Outline

The watch list comprises entities where failure is not presently considered more probable than not, but which nonetheless remain vulnerable.

All 11 of these entities are ranked either high (2) or medium (9) risk by the RBNZ and material deterioration in the liquidity, credit quality or capital metrics is likely to result in a provision being required.

All 11 of these entities form part of the stage two monitoring / investigation / analysis process, and will be closely monitored to ensure that any deterioration in their key financial metrics is detected to enable a provision to be made as necessary.

All 7 of the entities were on the watch list for November, 4 are new to the watch list and 4 have been removed from the watch list.

		Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Guaranteed Deposits $m	Estimated Loss-Given Default
Entities New to the Watch List								
Entity	Allied Nationwide Finance Limited	7.5	34	5.4	2.4	6,122	202	24
Entity Type	Finance Company	Treasury has had limited contact with Allied Nationwide to date, however they have been inspected. Throughout the inspection ANFL were remiss in providing KordaMentha with information (at worst deceitful) and need to be treated with caution. Allied Nationwide was provioned for in November 2009, however it is reconmend that Allided Nationwide be taken out of the provision for December 2009 as Allied Nationwide's parent (Allied Farmers) has received a $7m equity (cash) injection from Resimac, which is to be applied to ANF, in addition the approval process for the $400m in equity (loans) injection from Hanover investors to Allied Farmers has been approved. $40m to $50m of the equity injection is to be provided to ANF (by way of the high quality loans). The result of these two equity injections is that ANF will be very well capitalised. In addition, short term liquidity acceptable, and management changes are occurring. A face to face meeting to be set up with ANF and weekly liquidity data to be sourced from RBNZ,						
Status (Last Month/This Month)	Provisioned For/On Watch List							
Relative Riskiness								
Credit Rating	Not rated							
Amend and Replace Status	Completed							
Extended DGS Status	Not applied							

[3]

6. WATCH LIST

		Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Guaranteed Deposits $m	Estimated Loss-Given Default
Entities Remaining on Watch List								
								[3]
Entity	Equitable Mortgages Limited	1.2	58	1.7	7.0	5,387	179	26
Entity Type	Finance Company	Treasury has had considerable direct contact to date with Equitable. Equitable has been inspected, and an additional information request has been sent. A responce to the information request has been received - progress in asset realisation is slow. The last S&P report was released in September 09 (BB negative outlook), dialog to continue to ensure that the credit profile of Equitable continues to improve. A face to face meeting with Equitable is to be set up, weekly liquidity data to be sourced from RBNZ, and independent monitoring to be considered.						
Status (Last Month/This Month)	On Watch List/On Watch List							
Relative Riskiness								
Credit Rating	BB							
Amend and Replace Status	Completed							
Extended DGS Status	Not applied							
Entity	Rockforte Finance Limited	11.0	32	9.4	17.5	114	4	-
Entity Type	Finance Company	Treasury has had considerable direct contact to date with Rockforte due to the possability that the Corwn Deed of Guarantee is called. Treasury is being kept up to date with developments in regard to Rockforte as they happen. There seems to be good interest in the Rockforte book, Rockforte appear well manged and there no expected loss given default so no provision is recomended at this stage, however this is subject to change and we are monitoring the situation daily. Avanti are interested in purchasing Rockforte, have the funding but do not want to purchase the commercial book of Rockforte and have asked for government assistance - which has been declined. Trustee has been "commercial", in that they are seeking a sale of the book rather than receivership. Dialog to continue with involved parties to ensure that we are aware of the situation as it progresses. An inspection is to be considered.						
Status (Last Month/This Month)	On Watch List/On Watch List							
Relative Riskiness								
Credit Rating	Not rated							
Amend and Replace Status	Withdrawn							
Extended DGS Status	Not Eligible							
								[3]

6. WATCH LIST

		Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Guaranteed Deposits $m	Estimated Loss-Given Default

[3]

6. WATCH LIST

	Liquidity[1] x's	Asset Quality[2] %	Income Margin[3] %	Capital Ratio[4] %	Guaranteed Depositors #	Guaranteed Deposits $m	Estimated Loss-Given Default
Entities to be Removed from the Watch List							

[3]

7. METHODOLOGY

Information

In developing the recommended provision Treasury has relied primarily on information collected as part of the monitoring conducted by the Reserve Bank of New Zealand ("RBNZ"). That information includes but is not limited to monthly financial information which is to be reconciled with the annual and semi annual reports of the entities to ensure its accuracy. RBNZ are contracted by The Treasury to use this information to provide an assessment of the possible loss to the Crown in event of default of an entity.

The Treasury also uses additional information sourced directly from the entities covered by the Deposit Guarantee Scheme ("DGS"), Inspections (where these have been conducted) and from other market participants (Government Agencies, Banks, Professional Services Firms etc) in our assessment of the possible loss to the Crown in event of default of an entity.

Provisioning Recommendation

The provisioning recommendation made to the provisioning committee is made up of three components, **loss given default**, **post acceleration interest** and **net effect of discounting**.

To arrive at a **loss given default** for an entity, the RBNZ undertakes a loss given default assessment of the loan book to arrive at a discounted loan book value, which is then added together with other assets held by the entity (after discounting) to calculate the liquidated value of total assets. Total assets are then applied to the Total liabilities (including an allowance for "costs") to assess the equity shortfall (if any) and the Crown's loss under a liquidation scenario or loss given default.

The RBNZ model output is then reviewed by The Treasury to assess the appropriateness of the indicated loss given the additional information held by The Treasury, and adjustments are made as required. This process also includes arriving at an estimation of the expected timing of an entities default.

To arrive at an estimate of the Crown's **post acceleration interest** liability given the failure of an entity, the Treasury models the post acceleration interest liability using the date an entity is expected to fail, the level of guaranteed deposits, the terms of those deposits (term, interest rate, trust deed and Crown Deed of Guarantee provisions, etc) and the expected timing of depositor repayment.

The provisioning recommendation has been completed on the basis that post acceleration interest is payable, which is the case for the current and the amended and restated deed. Once the extension deed is on foot (post 12 October 2010) post acceleration interest is no longer payable.

The post acceleration interest model is then enhanced with a forecast of payout and receivers distributions. The cash outflows (post acceleration interest and payment of depositors) and the cash inflows (receivers distributions) are then discounted using GSF (risk free) discount rates so that the provision can be adjust for the **net effect of discounting**.

The provisioning recommendations are then presented to the provisioning committee to review and agree the appropriate level of the provision.

7. METHODOLOGY

Accounting Standards

The accounting issues and financial reporting standards that The Treasury has followed to establish this provision are as follows:

1. Initial recognition and measurement of the fair value of the guarantee at inception (IAS 39.9);
2. Recognition of premium received (IAS 18);
3. Measurement of a provision (NZIAS37:14 & NZIAS 37:36);
4. Triggering (recognition) of a provision (NZIAS37:14); and
5. Disclosures of the Crown's exposure (NZIAS 39, NZIFRS 7);

A detailed note on these was prepared by Ken Warren (i-manage 1247592), which included commentary on application of the financial reporting standards standards to our specific circumstances.