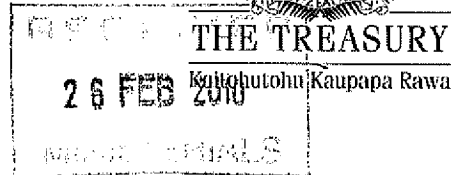


Hon Bill English  
**ORIGINAL**



**Treasury Report: Update on firms under the DGS**

Date:	23 February 2010	Report No:	T2010/273
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**Action Sought**

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	<b>Note</b> for your Information. <b>Signal</b> if you are not content with the proposed approach and would like more advice before we communicate with the firm. <b>Forward</b> this report to the Prime Minister.	It would be helpful for any concerns to be raised before midday Wednesday 24 <sup>th</sup> February.

**Contact for Telephone Discussion (if required)**

Name	Position	Telephone	1st Contact
Brian McCulloch	Director - Financial Operations	[Withheld under s.9(2)(a)]	✓
John Park	Team Leader - Guarantee Teams		

**Minister of Finance's Office Actions (if required)**

Provide a copy of this note to the Prime Minister.

Enclosure: No

26 FEB 2010

23 February 2010

## **Treasury Report: Update on firms under the DGS**

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### **Executive Summary**

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This report provides you with an update on the situation regarding South Canterbury Finance Limited (SCF).

SCF are required to issue their unaudited results for the period ending 31 December 2009 by the end of this week (26 February). SCF are also required to issue their audited results no later than 31 March 2010. The 26 February announcement is likely to include detail of a significant bad loan provision.

Alongside the release of their results, SCF is working towards announcing plans for a recapitalisation of the company. This will be necessary to ensure they remain compliant with their Trust Deed.

As part of putting their capital raising plans in place, SCF have requested that the Treasury make an affirmative statement that SCF has been accepted into the extended guarantee scheme or a statement that SCF will be accepted into the scheme subject to conditions (for example receipt of audited financial statements satisfactory to Treasury). SCF say that acceptance or conditional acceptance into the extended scheme will be necessary to maintain depositor confidence in investing with SCF.

The Chief Executive of SCF is meeting with Treasury officials on Wednesday 24 February at 12.30pm. The Treasury intends to inform SCF that it is not possible to provide either early acceptance or conditional acceptance into the scheme in advance of the completion of the firm's capital raising plans.

*[Withheld under s.9(2)(d)]*

In line with our previous advice around failure management we will undertake further analysis as necessary considering the potential impacts of the failure of SCF and the case for use of statutory management or asset management options. These options would only be considered in the event that they would likely produce a materially better outcome than normal commercial failure resolution processes (e.g. receivership).

## Recommended Action

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We recommend that you:

- a **Note** the contents of this report.

*Agree/disagree.*

- b **Alert** the Treasury if you have any concerns with the proposed Treasury approach to this issue.

*Agree/disagree/request more information.*

- c **Forward** this note to the Prime Minister for his information

*Agree/disagree*



Dr Brian McCulloch  
**Director – Financial Operations  
for Secretary to the Treasury**



Hon Bill English  
**Minister of Finance**

## Treasury Report: Update on firms under the DGS

### Purpose of Report

1. This report provides you with an update on the situation regarding South Canterbury Finance Limited (SCF). SCF are required to issue their unaudited results by the end of this week (26 February). SCF are also required to issue their audited results no later than 31 March 2010. The 26 February announcement is likely to include detail of a significant bad loan provision.
2. Alongside the release of their results SCF is working towards announcing plans for a recapitalisation of the company. SCF have requested that Treasury provide a affirmative statement that SCF has been accepted into the extended guarantee scheme or a statement that SCF will be accepted into the scheme subject to conditions (for example receipt of audited financial statements satisfactory to Treasury).
3. The purpose of such statements is to assist in the completion of SCF's recapitalisation plans and to maintain depositor confidence in investing with SCF. To do this, the Treasury statement would need to be made public.
4. This report sets out the Treasury's assessment of the situation and planned approach to take with SCF in responding to their request.

### Background on SCF position and recapitalisation

5. SCF are required to disclose their unaudited results to 31 December 2009 to the NZX by Friday 26 February (with audited results required by no later than 31 March 2010). These results are expected to include a significant provision for bad loans, following the appointment of a new auditor to the firm.
6. Alongside the announcement of their results SCF will need to be able to publicly state that the firm remains compliant with its Trust Deed. Given the scale of the anticipated provisions this will require SCF to announce a recapitalisation plan alongside the release of its results in order to enable continued compliance with the Trust Deed's covenants.
7. We understand from the Trustee that under the terms of its Trust Deed, SCF can remain compliant even with an inadequate capital position provided it has in place a recapitalisation plan which will remedy any breach of the Trust Deed within three months.
8. SCF have two main pillars to their recapitalisation plan. The first involves intra-group transactions moving Helicopters New Zealand and Scales Corporation into SCF from Southbury Group, with consideration of shares in SCF going to Southbury Group in return. This should represent approximately \$150m of new capital into SCF. While this will require a consent under the Crown Deed or Guarantee, that in of itself is not seen as being problematic.
9. The second pillar involves a transaction with \* - a finance company currently in moratorium. This transaction would be similar in substance to the transaction involving [Withheld under s.9(2)(b)(ii)] . In this case it would involve debenture holders in the \* receiving an equity stake in SCF in lieu of their claim in the moratorium of \*  
\* [Withheld under s.9(2)(b)(ii)]
10. Completion of these transactions should result in a significant recapitalisation of SCF sufficient to ensure it continues to meet its obligations under its Trust Deed, despite making large bad debt provisions in its 2009 accounts.

11. SCF have applied to join the extended retail guarantee scheme. The Treasury has not yet decided their application. We are waiting for the company to provide its audited December financial statements, as well as for information from the Trustee<sup>1</sup>. The information that has been requested from the Trustee is part of the normal procedures used for the processing of applications.
12. As already noted, SCF have requested that Treasury either accepts their application or at least provides some form of conditional acceptance into the scheme. They consider that this would assist them in completing their recapitalisation plans and reduce the likelihood of near term liquidity problems following the release of their results. As part of this they are seeking that the Treasury agree to write to the trustee of \* indicating this affirmative position regarding the SCF application for the extended retail scheme.
13. We understand (based on advice received yesterday) that SCF has yet to have discussions with their Trustee regarding their recapitalisation plans.

\* [Withheld under s.9(2)(b)(ii)]

### Treasury Position

14. Treasury does not favour providing SCF with acceptance or conditional acceptance into the scheme in advance of its outstanding information requests being satisfied. For instance the information that has been requested of the Trustee is regarded as important to enable Treasury to properly make its decision as to whether SCF's acceptance into the extension guarantee scheme is in the public interest. The same comment equally applies to receipt of the audited financial results of the company, particularly where significant additional provisioning has been signalled.
15. It should also be noted that the request made of Treasury by SCF is exceptional in that an affirmative statement regarding SCF's acceptance into the extension guarantee scheme is intended to influence the outcome of commercial transactions (particularly those commercial transactions in which the Crown may benefit financially).

[Withheld under s.9(2)(h)]

17. Another option that has been considered is acceptance of SCF into the extension guarantee scheme, with a deed that contains terms that are much stricter than those contained in the standard deed for that scheme. This "stricter deed" would include additional powers enabling the Crown to withdraw the guarantee on additional grounds for withdrawal and on a more rapid basis.

[Withheld under s.9(2)(h)]

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<sup>1</sup> The Trustee has not yet been able to provide a response to the Treasury concerning the SCF application for the extended retail scheme as they themselves have not yet had a response from SCF regarding their solvency, given the uncertainty caused by the level of provisions SCF has signalled

18. Treasury considers that most that could be done in these circumstances (without undue risk and without adversely affecting the application process for the extension guarantee scheme going forward) is to provide a letter to the Trustee for the *[Withheld under s.9(2)(b)(ii)]* investors, advising it that based on the information currently available Treasury regards the recapitalisation proposal and the resulting new capital as not being prejudicial or detrimental to SCF's application to participate in the extended guarantee scheme. That letter would however also need to make it clear that at this point, Treasury is not in a position to provide an indication as to the outcome of SCF's application for acceptance into the extension guarantee scheme.

#### Other Risks

19. *SCF Failure and fiscal risk*: There is a risk that, without a signal from Treasury that SCF will be accepted into the extended guarantee scheme, SCF may not be able to complete the recapitalisation proposal and find itself under severe liquidity pressure as depositor confidence would desert it. It would also be under pressure to find an alternative capital solution rapidly to prevent the Trustee declaring it in breach of the Trust Deed.

20. In such a scenario SCF could fail relatively rapidly, either through action by the Trustee, or at the request of the Directors of SCF. This would crystallise the fiscal risk for the Crown. However that is a fiscal risk that has already been provisioned for, in the Crown accounts.

21. *[Withheld under s.9(2)(d)]*

22.

23.

24.

## Next Steps

25. Treasury officials are meeting with SCF on Wednesday to discuss their proposed recapitalisation. We intend to use this meeting to signal that we will not provide an acceptance or conditional acceptance into the extended retail scheme at this point in time, given that the information to properly fully consider the public interest tests on which a decision needs to be based is not yet available.
26. We will advise SCF that the most we are prepared to say is that based on the information currently available Treasury regards the recapitalisation proposal and the resulting new capital as not being prejudicial or detrimental to SCF's application to participate in the extended guarantee scheme.
27. In line with our previous advice<sup>2</sup> around failure management we will undertake further analysis as necessary considering the potential impacts of the failure of SCF and the case for use of statutory management or asset management options. These options would only be considered in the event that they would likely produce a materially better outcome than normal commercial failure resolution processes (e.g. receivership).
28. We will keep you informed of any further developments.

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<sup>2</sup> TR2010/29 Asset Management: Triggers and Governance Arrangements