

# The Treasury

## Budget 2015 Information Release

### Release Document July 2015

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- [1] 6(a) - to prevent prejudice to the security or defence of New Zealand or the international relations of the government
- [2] 6(c) - to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial
- [3] 6(e)(iv) - to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.
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- [7] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
- [8] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [8a] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting the collective and individual ministerial responsibility
- [9] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [10] 9(2)(h) - to maintain legal professional privilege
- [11] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [12] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [13] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [14] Not in scope

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

## Treasury Report: Southern Response Earthquake Services

<b>Date:</b>	17 April 2015	<b>Report No:</b>	T2015/778
		<b>File Number:</b>	CM-1-3-112-1

### Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	<p>Agree to establish proposed appropriations in Budget 2015</p> <p>Agree to sign and table the attached briefing note for Cabinet</p> <p>Note that the proposed appropriation impacts are not counted as the fiscal impacts against Budget allowances</p>	<p>Monday 20 April 2015, 10am</p> <p>Before Cabinet consideration of Budget package</p>
Minister for Canterbury Earthquake Recovery (Hon Gerry Brownlee)	<p>Agree to establish proposed appropriations in Budget 2015</p> <p>Agree to sign and table the attached briefing note for Cabinet</p> <p>Note that the proposed appropriation impacts are not counted as the fiscal impacts against Budget allowances</p>	<p>Monday 20 April 2015, 10am</p> <p>Before Cabinet consideration of Budget package</p>
Associate Minister of Finance (Hon Steven Joyce)	<p>Agree to establish proposed appropriations in Budget 2015</p> <p>Agree to the performance exemptions</p> <p>Note that the proposed appropriation impacts are not counted as the fiscal impacts against Budget allowances</p>	<p>Monday 20 April 2015, 10am</p> <p>Before Cabinet consideration of Budget package</p>

### Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
David Stanley	Principal Advisor, Governance and Performance, Commercial Operations	[4]	✓
Fiona Chan	Manager, Governance and Performance, Commercial Operations		

### Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury

Table the attached paper at Cabinet on Monday 20 April

**Enclosure:** [CER Min - Southern Response: Uncalled Capital for Solvency Support \(Treasury:2469560v1\)](#)

## Treasury Report: Southern Response Earthquake Services

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### Introduction

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Southern Response Earthquake Services' (SRES) insurance liabilities have risen to a level where it is now probable that SRES will need to make a call of additional capital under the Crown Support Deed. This will result in operating and capital expenditure for Vote Finance and as a result, the Minister of Finance and Minister for Canterbury Earthquake Recovery should exercise their joint authority to create the necessary appropriations. Treasury recommends the appropriations are a maximum of \$500 million, being the full amount of capital available to SRES but uncalled under the Crown financial support arrangements.

This appropriation impacts on 2014/15 and therefore needs to be approved before the budget moratorium takes effect on 20 April 2015.

The impact on net debt is currently estimated at \$305 million rather than the maximum appropriation sought. Although the capital will be immediately impaired, the \$305 million will not impact on OBEGAL as the operating impact is already included in forecasts. SRES is fully consolidated into the Crown accounts. It is recommended that the capital is not counted against the Future Investment Fund given it will be immediately impaired. The only additional impact on OBEGAL is the appropriation for unwind of discount rates at \$5 million, but it is recommended this does not count against the Budget allowance as any recognition will offset against lower recognition of impairment. Because of this none of the appropriation impacts should be counted against Budget allowances.

This paper also requests approval for exemptions from performance reporting for the new appropriations under section 15D(2)(b)(ii) of the Public Finance Act 1989, as additional performance information is unlikely to be informative because the capital appropriation is solely to invest in Southern Response Earthquake Services Ltd in accordance with the Crown Settlement Deed and the operating appropriation is to reflect technical accounting treatment.

Finally we recommend that the authorised Ministers report on this action by way of a brief noting paper to Cabinet on 20 April 2015.

### Background

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On 15 October 2012, the Cabinet Committee on Canterbury Earthquake Recovery made a number of decisions [CER Min (12) 10/1 refers], including:

1. agreement to provide for additional support to Southern Response Earthquake Services (SRES) by way of subscription for uncalled capital up to \$500 million to be callable by SRES if required only after its investments, reinsurance and previously existing Crown support was exhausted
2. noting that no appropriation was necessary at that time as the then assessed probability of substantial calls was low, but recognizing that if the probability of calls increased to 50 per cent or greater, then an appropriation would be required
3. authorisation for the Minister of Finance and Minister for Canterbury Earthquake Recovery jointly to approve the necessary appropriation, and

4. agreement that any appropriation so made be met from imprest supply until it could be included in the next Supplementary Estimates where it would count against the Canterbury Earthquake Recovery Fund.

In light of recent developments, Treasury considers that the probability that SRES will need to make substantial calls on the uncalled capital is higher than 50 percent. In particular we note that:

- Since 30 June 2014, the independent actuary Finity Consulting's (Finity) inflated gross central estimate of SRES's insurance liabilities has increased by \$328 million to \$2,693 million, including an increase of \$154 million in the quarter to 31 March 2015. This increase is primarily due to the emergence of higher than expected volumes of newly reported overcap claims being transferred from EQC.
- As a result SRES now shows a shareholders' funds deficit of \$399 million, before calls on uncalled capital, and after adding a risk margin of \$119 million. This compares with a shareholders' funds deficit at 30 June 2014 of \$112 million.
- [8]

## Financial Implications

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[8]

It is now probable that there will be a call against the \$500 million and Treasury recommends that the required appropriations be approved. The structure of the appropriations mirrors those established in Budget 2011 when the initial called capital was provided to SRES (then AMI).

A capital appropriation of \$500 million is sought for an investment in SRES which will be immediately impaired, for which an operating appropriation is also required. The operating appropriation for \$500 million will not directly impact on OBEGAL as the operating impact will be reflected through the financial results of SRES in the consolidated Financial Statements of Government. However there will be an impact on net debt for the \$500 million.

At this stage it is estimated that \$300 million will be recognised against this appropriation, and that this could increase to \$305 million by June 2015 due to the unwind of the discount rate and payment dates. An appropriation is sought for the unwind of the discount rate, which will not count against the 2015 Budget operating allowance as it will be offset by under-expenditure in the capital and impairment appropriations. However this appropriation of \$5 million sought for the unwind will be an additional impact on OBEGAL.

Recognition against the capital and impairment appropriations will be lower than the \$500 million at June 2015, but at this stage we cannot easily determine the precise figures. On this basis the maximum appropriations are sought.

Any lower recognition however will result in higher levels of appropriation necessary to recognise the unwind of the discount rate and payment date changes in outyears. Therefore this paper also requests an in-principle expense transfer for under-expenditure in any of the proposed 2014/15 appropriations and for that to be applied to the Non-Departmental Other Expense: Unwind of Discount Rate Used in the Present Value Calculation of Payment Under Crown Deed of Support with Southern Response Earthquake Services Ltd.

The Public Finance Act 1989 permits appropriations to be exempted from end-of-year performance reporting requirements where certain criteria are met and the Minister of Finance has granted an exemption. Approval is sought, from Hon Joyce in his capacity of Minister of Finance for appropriations in Vote Finance, for exemptions from performance reporting for the new appropriations under section 15D(2)(b)(ii) of the Public Finance Act 1989. It is assessed that additional performance information is unlikely to be informative because the capital appropriation is solely to invest in Southern Response Earthquake Services Ltd in accordance with the Crown Settlement Deed and the operating appropriation is to reflect technical accounting treatment.

## Recommended Action

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We recommend that you:

- a **note** that the probability that Southern Response Earthquake Services (SRES) makes calls for a substantial proportion or all of the uncalled capital under the Crown Support Deed has risen sufficiently to require appropriations to be established
- b **note** that the Minister of Finance and the Minister for Canterbury Earthquake Recovery are jointly authorised by Cabinet to agree the necessary appropriation, and that no appropriation has been made to date for the uncalled capital
- c **note** that the proposed appropriation impacts below are not included in Budget 2015 recommendations
- d **note** that the proposed appropriation impacts below will have a \$5 million additional impact on OBEGAL in 2014/15, have an estimated \$305 million on net debt (appropriation at maximum level of \$500 million) and will not count against Budget 2015 allowances or the Future Investment Fund

e **agree** to establish the following new appropriations:

<b>Vote</b>	<b>Appropriation Minister</b>	<b>Title</b>	<b>Type</b>	<b>Scope</b>
Finance	Minister of Finance	Southern Response Earthquake Services Ltd Equity Investment	Non-Departmental Capital Expense	This appropriation is limited to the investment in Southern Response Earthquake Services Ltd.
Finance	Minister of Finance	Impairment of Investment in Southern Response Earthquake Services Ltd	Non-Departmental Other Expense	This appropriation is limited to the impairment of equity investment in Southern Response Earthquake Services Ltd.

f **agree** to amend the scope of the following appropriation to recognise the change in company name from AMI to SRES:

<b>Status</b>	<b>Vote</b>	<b>Appropriation Minister</b>	<b>Title</b>	<b>Type</b>	<b>Scope</b>
Current	Finance	Minister of Finance	Unwind of Discount Rate used in the Present Value Calculation of Payment under Crown Deed of Support with AMI	Non-Departmental Other Expense	This appropriation is limited to the expense incurred in unwinding the discount rate used in the present value calculation of the liability as the liability nears settlement.
Proposed Revision	Finance	Minister of Finance	Unwind of Discount Rate Used in the Present Value Calculation of Payment Under Crown Deed of Support with Southern Response Earthquake Services Ltd	Non-Departmental Other Expense	This appropriation is limited to the expense incurred in unwinding the discount rate used in the present value calculation of the liability as the liability nears settlement.

- g **agree** to increase expenditure to provide for the increase in likelihood that the uncalled capital will be called, with the following impacts on the operating balance and debt:

	\$m – increase/(decrease)				2018/19 & Outyears
	2014/15	2015/16	2016/17	2017/18	
Operating Balance Impact	5.000	-	-	-	-
Debt Impact	500.000	-	-	-	-
No Impact	500.000	-	-	-	-
<b>Total</b>	<b>1,005.000</b>	-	-	-	-

- h **approve** the following changes to appropriations to give effect to the increase in likelihood that the uncalled capital will be called, as outlined in recommendation a above:

Vote Finance Minister of Finance	\$m – increase/(decrease)				2018/19 & Outyears
	2014/15	2015/16	2016/17	2017/18	
Non-Departmental Other Expense:					
Unwind of Discount Rate Used in the Present Value Calculation of Payment Under Crown Deed of Support with Southern Response Earthquake Services Ltd	5.000	-	-	-	-
Impairment of Investment in Southern Response Earthquake Services Ltd	500.000	-	-	-	-
Non-Departmental Capital Expenditure:					
Southern Response Earthquake Services Ltd Equity Investment	500.000	-	-	-	-

- i **note** that the proposed capital appropriation will impact on net debt as reflected in the table in recommendation f above, but that the net debt impact will be phased over a number of outyears reflecting the cash payment profile
- j **note** that the current projection of impact on net debt is \$305 million and this will be shown as the estimated actual in the 2015 Budget Economic and Fiscal Update
- k **agree** that the proposed capital appropriation does not count against the Future Investment Fund as the capital expenditure will be immediately impaired
- l **note** that proposed operating appropriation for the impairment of the investment will not impact on OBEGAL as the operating impact is already reflected in the consolidation of SRES into the Financial Statements of Government
- m **note** that the proposed operating appropriation for the Non-Departmental Other Expense: Unwind of Discount Rate Used in the Present Value Calculation of Payment Under Crown Deed of Support with Southern Response Earthquake Services Ltd will impact on OBEGAL, but will not count against the Budget 2015 allowance as any recognition will be offset by a lower impairment

- n **agree** that the proposed changes to appropriations for 2014/15 above be included in the 2014/15 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply
- o **agree** that any under-expenditure in 2014/15 against the appropriations established above be transferred into outyears to address recognition timing issues
- p **agree** to exempt the following appropriations from end-of-year performance information requirements for as long as the exemption criteria continue to be met

Vote	Appropriation	PFA provision under which exemption is sought:	(\$millions)
Finance	Impairment of Investment in Southern Response Earthquake Services Ltd	s15D(2)(b)(ii), as additional information is unlikely to be informative because this appropriation is solely for the technical accounting treatment for impairment of investment	500
	Southern Response Earthquake Services Ltd Equity Investment	s.15D(2)(b)(ii), as additional performance information is unlikely to be informative because this appropriation is solely to invest in Southern Response Earthquake Services Ltd in accordance	500

*Agree/disagree*

Associate Minister of Finance

- q **agree** to submit the attached noting paper to Cabinet on 20 April 2015 advising that this action has been taken.

Fiona Chan

**Manager, Governance and Performance, Commercial Operations**

Hon Bill English

**Minister of Finance**

Hon Gerry Brownlee

**Minister for Earthquake Recovery**

Hon Steven Joyce

**Associate Minister of Finance**

## **Cabinet Paper: Southern Response Appropriation for Future Calls under Crown Financial Support Arrangements**

**Portfolios: Finance/Canterbury Earthquake Recovery**

### **Background**

1. On 15 October 2012, the Cabinet Committee on Canterbury Earthquake Recovery made a number of decisions [CER Min (12) 10/1 refers], including:
  - 1.1 agreement to provide for additional support to Southern Response Earthquake Services (SRES) by way of subscription for uncalled capital up to \$500 million to be callable by SRES if required only after its investments, reinsurance and previously existing Crown support was exhausted
  - 1.2 noting that no appropriation was necessary at that time as the then assessed probability of substantial calls was low, but recognizing that if the probability of calls increased to 50 per cent or greater, then an appropriation would be required
  - 1.3 authorisation for the Minister of Finance and Minister for Earthquake Recovery jointly to approve the necessary appropriation, and
  - 1.4 agreement that any appropriation so made be met from imprest supply until it could be included in the next Supplementary Estimates where it would count against the Canterbury Earthquake Recovery Fund.
2. In light of recent developments, we consider that the probability that SRES will make substantial calls on the uncalled capital is higher than 50 percent. In particular we note that:
  - 2.1 Since 30 June 2014, the independent actuary Finity Consulting's (Finity) inflated gross central estimate of SRES's insurance liabilities has increased \$328 million to \$2,693 million, including an increase of \$154 million in the quarter to 31 March 2015. This increase is primarily due to the emergence of higher than expected volumes of newly reported overcap claims being transferred from EQC.
  - 2.2 As a result SRES shows a shareholders' funds deficit of \$399 million in the Crown accounts, before calls on uncalled capital, and after adding a risk margin of \$119 million. This compares with a shareholders' funds deficit at 30 June 2014 of \$112 million.
  - 2.3 [8]
  - 2.4

2.5 [8]

3. As the probability that SRES will make substantial calls on the uncalled capital is higher than 50 percent it has become necessary to establish the appropriations to give effect to the agreement to allow for further call on capital of up to \$500 million. [8]

**Action taken**

4. Through our joint authority from Cabinet to approve the necessary appropriation, we have therefore agreed to the following appropriation changes:

Vote Name Minister of/for Portfolio	\$m – increase/(decrease)				
	2014/15	2015/16	2016/17	2017/18	2018/19 & Outyears
Non-Departmental Other Expense: Unwind of Discount Rate Used in the Present Value Calculation of Payment Under Crown Deed of Support with Southern Response Earthquake Services Ltd	5.000	-	-	-	-
Impairment of Investment in Southern Response Earthquake Services Ltd	500.000	-	-	-	-
Non-Departmental Capital Expenditure: Southern Response Earthquake Services Ltd Equity Investment	500.000	-	-	-	-

5. The capital equity contribution will be immediately impaired, for which an appropriation is also required. Only the \$5 million for unwind of discount rates will impact on OBEGAL. The operating impact of impairing the capital equity contribution is already reflected in the consolidation of SRES into Financial Statements of Government.
6. There will be an impact on net debt for the \$305 million (current projection although maximum appropriation sought for \$500 million) but this impact will not be counted against the Future Investment Fund as it has been immediately impaired. The appropriation for the unwind of the discount rate will not count against the 2015 Budget operating allowance as it will be offset by under expenditure in the capital and impairment appropriations.

Hon Bill English  
**Minister of Finance**

Hon Gerry Brownlee  
**Minister for Canterbury Earthquake Recovery**