

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.

From: Sandy Maier [1]
Sent: Monday, 31 May 2010 10:57 p.m.
To: John Park; [1]
Subject: Letter
Attachments: SCF Letter - Treasury 31May10.doc

John:

Thanks for your patience today.

Could you please have a look at the attached letter?

I will sign and send it in the morning.

Cheers -- Sandy

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(20100531) _____

The message was checked by ESET NOD32 Antivirus.

<http://www.eset.com>

31 May 2010

Dr Brian McCulloch
Director Financial Operations
The Treasury
WELLINGTON

SOUTH CANTERBURY FINANCE LIMITED

1. We refer to your letter of today to SCF and our discussions subsequent to receipt of that letter, during which you invited further information from SCF in support of our request for consent.
2. In relation to the reasons summarised in paragraph 6 of your letter we make the following points
 - (a) The transaction is in all relevant respects the same as the transaction involving the issue of convertible notes effected on 31 December 2009, to which Treasury consented. The reasons you advance in paragraphs 6.1 and 6.2 of your letter would have applied equally to that transaction.
 - (b) It is not in our view true to say the transaction is “solely designed” to remedy a breach of a ratio in the SCF Debenture Trust Deed. The transaction has that effect, because it improves the financial position of SCF. It improves both the equity position and liquidity of the company and as a consequence the ratio breach is remedied.
 - (c) This is the same as the position at 31 December for which consent was granted to the earlier equivalent transaction. The transaction was effected in that manner, at that time, to remedy a ratio breach expected to occur at 31 December. It had been made clear to Treasury in numerous forms of correspondence up to the consent request in December that a private placement was being undertaken to improve the equity position of SCF ie not just a liquidity raising. The transaction was structured as it was in order to be effective and successful at that time. It is not the position that the transaction in December was done just for liquidity purposes. Had that been the case, a loan directly from SCF to a third party secured by a prior charge would have been undertaken. In this respect we are surprised that this transaction is regarded as being different to that in December. However we appreciate this could have been made clearer to you in our consent request.
 - (d) In paragraph 6.2 of your letter you have indicated that the transaction will not provide “real equity”. However, the auditors of SCF, Ernst & Young, have treated the \$26.4 million raised from Southbury Corporation Limited (by the December issue of convertible notes) as equity of SCF for the purposes of the financial statements as at 31 December 2009. On the basis that that is the proper accounting treatment, and that this is the opinion of an internationally respected auditor (who undertook a vigorous review of the company’s December half-year accounts), we do not see how this cannot be considered as equity.

- (e) In relation to the Trust Deed ratios and what constitutes compliance, this is overseen and inspected by the Trustee who takes a close interest in whether and how the company complies with requisite ratios.
 - (f) We appreciate that a consequence of a failure of SCF is that the prior charge securing the notes issued by Southbury Corporation would likely be called upon (if Southbury Corporation cannot repay the notes). In this respect, whether the funds raised by SCF are in this equity form or in a loan form, it would not change the Crown's position with respect to a failure (albeit that under the equity form there is also an indemnity from Southbury Corporation). In which case we understand your concern relates to whether or not this equity injection is "real equity" and we reiterate our arguments in (c) and (d) above, that in fact this is equity as confirmed by Ernst & Young.
 - (g) In commercial substance, the transaction cannot on any view be worse than a borrowing of money by SCF on the terms recorded in the Southbury Corporation convertible notes (see paragraphs 10(b) and (c) of SCF's letter seeking consent).
 - (h) In relation to paragraph 6.3, we believe it has been known by Treasury for some time that the proposed initial public offering of preference shares is now unlikely to occur. In reality the market is not right for an IPO at this time and circumstances have evolved at SCF and Southbury as well. There was no undertaking to IPO the company, simply an intention at the time. It has become clear that a more significant transaction is achievable as described in 3(e) below. These alternative proposals for restructuring and capital raising are under active negotiation. Your consent to our request will assist with our completion of this exercise which in our opinion will be materially beneficial to the Crown's position.
3. Subsequent to our letter there have been a number of matters which we believe are relevant to further consideration of our consent request:
- (a) We have decided to modify the form of Southbury Corporation's investment into SCF such that it is a subordinated capital security, most likely a perpetual capital note redeemable at SCF's option. In reality, to ensure compliance with the Trust Deed ratio that is in breach, SCF does not require ordinary equity to be injected. Capital in a different form will enable compliance. With the benefit of more thought, a more flexible security will help SCF and Southbury will regards to the capital raising exercise underway and allows repayment to be considered should we be successful in downsizing SCF's balance sheet through the intended restructuring and capital raising exercise underway. We also point out that to the extent there are concerns about the perceptions around the prior charge and "equity", this modification improves that position.
 - (b) On Friday 28 May 2010, SCF announced the resignations of Messrs Allan Hubbard and Edward Sullivan from the Board of SCF. As regards accountability for the position and losses incurred by SCF, this means the entire Board of SCF has been changed since last October. This includes the resignation of Mr Hubbard which, given his moves to inject equity through the addition of valuable assets and businesses, has ensured SCF has remained solvent and a going concern – clearly of benefit to all

stakeholders. You will appreciate that his resignation therefore has been a further significant gesture and significant step by the owner of the business to do what has been considered necessary to retain stakeholder confidence.

- (c) The liquidity position of the company has improved from last December and from the announcement of SCF's acceptance into the Crown's Extended Retail Deposit Guarantee Scheme in early April. This is despite challenging media headlines, various doomsayers blogging about the company and, more relevantly, debenture maturities as we enter the final six month period of the existing Crown Retail Deposit Guarantee Scheme.
- (d) We have been highly successful in targeting forward debenture maturities with offers to roll over investments early. As at 31 May, a total of \$132.9 million of debenture maturities mainly in June and July and August have accepted our offer to roll over their funds early. This represents 66% reinvestment from those returned. In effect this means it is the same dollar value in cash less that SCF needs to raise to refinance these maturities. Whilst this is not reflected in the cashflow information available to you in terms of "inflows", it significantly reduces the quantum of fund raising necessary in the short term to meet potential outflows. We are currently targeting the September and October maturities. News that SCF has been unsuccessful in obtaining the consents necessary for this equity raising to be completed, and a resultant ongoing breach of the trust deed ratio, we expect will have a material negative impact on these initiatives. This would be prejudicial to the interests of stakeholders, including the Crown as guarantor.
- (e) We are actively engaging with significant institutional investors who are considering the opportunity to invest materially into the group, and potentially SCF directly. A copy of some of the relevant pages from the Information Memorandum being circulated to interested parties will be sent to you separately. This describes the nature and structure of the investment being sought and describes how this assists SCF in becoming compliant with the non-bank deposit-taker regulations coming into effect over the coming year. The prospective investors are aware of the intended investment of new equity by Southbury Corporation, which is the subject of our consent request, and we are concerned that a decline of SCF's consent request will negatively affect our ability to successfully complete a meaningful transaction. This would be to the detriment of all stakeholders.
- (f) We are currently in receipt of a proposal which involves total investment of over \$450 million and in addition the potential acquisition of non-performing loans of up to \$200 million. The investment contemplates the current equity raising being completed. We would be willing, in confidence, to share this proposal, dated 27 May, with you to verify these points.
- (g) You will appreciate that until the extended guarantee acceptance was confirmed it was not possible to engage prospective investors given the uncertainties eventuating had there been a rejection. In some respects the issues are similar with respect to this latest consent request. Due

diligence is likely to take up to a few weeks and in the meantime it is imperative that we continue to operate with the confidence of the market, investors and wider stakeholders. A decline of our consent request is likely to have a significant negative effect on our ability to complete these tasks which, if successful, will have enormously positive benefits for stakeholders, especially SCF and the Crown as guarantor.

- (h) Since our letter of last week we have received confirmation from the Trustee of their consent to the transaction and use of the prior charge for this purpose.
4. We understand that Crown consent is required for this transaction due to the quantum of prior charges relative to the position at 1 April 2010 and due to the related party nature of the request. We appreciate Treasury has a requirement to exercise its discretion under the Deed of Guarantee to maintain public confidence in financial institutions. However we do not agree that declining our request is consistent with that position. For all of the reasons described above, and with the benefit of the new information, we believe it is strongly in the interests of public confidence that consent is granted.
5. Your consent will enable SCF to move forward with its ongoing plans for the future, and these are consistent with the interests of the Crown in seeing SCF emerge as a viable NBDT-compliant institution that can fund raise without the benefit of the Crown guarantee. This requires us to remain solvent and retain investor confidence in the meantime, matters which your consent would positively affect.
6. Finally we do wish to point out that there has been enormous change at SCF in recent months, despite substantial headwinds and general expectations of failure. Despite these difficulties we have been able to carefully navigate the way forward in such a way that SCF has remained solvent and with sufficient confidence that SCF has a viable future. We hope that our progress (and survival) has provided you with sufficient confidence with regard to our assertions about the future and what we expect can be achieved.
7. We have appreciated Treasury's support through this process to date and in particular with respect to the extended guarantee acceptance. We now respectfully request you reconsider your position, particularly in light of the additional information provided in this letter, and grant SCF the consent requested. This will enable us to "finish the job" and reduce the risk that stakeholders have from the current position.

Yours faithfully

Sandy Maier
Chief Executive Officer