

COMMERCIAL-IN-CONFIDENCE

Treasury Report: AMI Update - Moving Towards Completion

1. On 16 December 2011:
 - a AMI Insurance Limited agreed to transfer all of its on-going insurance business, and related business undertaking to its subsidiary AMI Insurance (Operations) Limited (**AMI New Co**), and
 - b IAG (NZ) Holdings Limited (**IAG**) agreed to purchase AMI New Co by way of a subscription for 380,000 shares of \$1.00 each in that company (the **IAG sale**).
2. The net IAG sale proceeds (after the costs of capitalising AMI New Co) will be available on completion to off-set the Crown's exposure to AMI Insurance Limited under the Crown Support Deed.¹
3. Completion is however contingent on the satisfaction of a number of statutory consents. Not all of these consents have been provided yet.
4. However, based on the information currently available it is now thought more likely than not that completion will take place on Thursday, 5 April 2012.

Purpose of Report

5. The purpose of this report is to:
 - a provide you with an update on where things stand as the IAG sale moves towards completion,
 - b provide you with an overview of:
 - i the completion process, and
 - ii the things to be done on the same day as completion to effect Crown control over AMI Insurance Limited, once business separation with AMI New Co and completion of the IAG sale has occurred,
 - c give you a brief description of the Crown's role on completion day and its role in fully establishing AMI Insurance Limited as a Crown owned company on that day and during the immediate period thereafter,
 - d propose that the Minister of Finance provides the Secretary of the Treasury with a delegation to facilitate the completion of the IAG sale and the Crown's assumption of control of AMI as a Crown owned company;
 - e propose that the Minister for Canterbury Earthquake Recovery provides the Chief Executive of the Canterbury Earthquake Recovery Authority with a delegation to facilitate the completion of the IAG sale and the Crown's assumption of control of AMI as a Crown owned company.

¹ Under the Crown Support Deed the Crown agreed to provide up to \$500 million of financial support to AMI Insurance Limited through the subscription of up to 500 million preference shares convertible into ordinary shares at the Crown's option.

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Report on progress towards completion

6. Completion of the IAG sale is conditional on certain consents being obtained from the Overseas Investment Commission, the Commerce Commission, the Financial Markets Authority and the Reserve Bank of New Zealand (the **RBNZ**).
7. All of these statutory consents have now been obtained other than those that need to come from the RBNZ. The RBNZ (whose job is the most complex) has three different sets of consents to provide and is still working on the consent process.² However, based on soundings taken with RBNZ by AMI and IAG, we understand that the RBNZ will be ready to make its final determinations on or shortly before 5 April 2012.
8. While the statutory consents are the principal legal requirements on which completion of the IAG sale is dependent there are other things that the IAG sale agreement anticipates will have been done in time for completion. These are subject to "best endeavours" obligations and are mostly concerned with matters that will enable AMI Insurance Limited and AMI New Co (under IAG ownership) to operate as separate businesses while at the same time providing the agreed forms of support to each other that are required (among other things) in order to properly service a shared policy holder base.³
9. Progress on these "completion readiness" requirements has generally been good. However it is not yet clear that:
 - all the consents to, and assignments for, all business agreements and leases to be transferred will have been obtained by completion,⁴
 - everything that needs to be done in relation to the transfer of AMI's super scheme to AMI New Co will have been effected as at the completion date.⁵
10. Failure to achieve all these things on time should not however prevent completion from proceeding as anticipated.
11. In addition there is considerable work being undertaken by AMI to ensure that any disruption to customers and staff resulting from the separation of the on-going AMI insurance business from the AMI residual Christchurch earthquake related claims management business will be avoided (as far as possible) or otherwise minimised. The aim here is to have well documented sets of policies and procedures, to undertake training and to conduct a number of "dry run" pre-completion exercises that simulate interactions with customers and interactions between residual AMI Insurance Limited and AMI New Co in the environment each will be operating in, once completion has occurred.

² The main piece of work that is outstanding is completion of an independent actuary review of the actuarial reports submitted by IAG and AMI in support of their respective consent applications

³ For instance it is possible that a customer whose policy has been transferred to AMI New Co will not have made a Christchurch earthquake related claim against AMI before completion. In that event while the policy will reside with AMI New Co, the financial responsibility for the policy as it relates to a Christchurch earthquake claim will continue to lie with AMI Insurance. Processes and procedures are required to ensure that that customer policy claims are treated in the manner contemplated by the IAG sale agreement but with minimal disruption to the customer. In addition AMI New Co has also agreed to provide information technology support and selective claims management support to AMI Insurance following completion.

⁴ The focus is moving to those business agreements that are more significant to the smooth separation of AMI into two businesses – mostly some of the key ICT agreements.

⁵ The superannuation trustee considers that certain FMA exemptions will be required. The FMA has advised that some additional steps will need to be undertaken in relation to the transfer of the superannuation scheme before it will issue the exemptions applied for.

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Overview of completion day activities

Completion of the IAG sale:

12. On or before the day of completion:

- AMI Insurance Limited and AMI New Co will pass shareholders' consents approving entry into the transactions contemplated by completion,
 - AMI Insurance Limited (and its subsidiaries) and AMI New Co will authorise changes to their respective business names (with AMI Insurance Limited authorising a change in name from AMI Insurance Limited to Southern Response Earthquake Services Limited) (**Southern Response**),⁶
 - AMI New Co is capitalised by Southern Response by the injection of \$120 million of share capital under board authorisation that is consented to by Southern Response's shareholders,
 - RBNZ issues AMI New Co with a license to carry on insurance in New Zealand and its approval to the transfer of Southern Response's on-going insurance business to AMI New Co,
 - Southern Response will transfer and AMI New Co will accept transfer of all of the on-going AMI insurance business along with all of its related business undertaking including the AMI brand and trademarks, transferring business agreements and leases, bank accounts, customer insurance contracts, and certain reinsurance contracts (that are not to be retained by Southern Response) and for which (in each case) all required third party consents have been obtained,⁷
 - RBNZ issues its approval to IAG taking control of AMI New Co, and AMI New Co authorises the issue of 380 million shares to IAG against payment by IAG of the IAG subscription price (\$380 million),
 - AMI New Co authorises the repurchase of its initial share capital (120 million ordinary shares of \$1.00 each held by Southern Response).⁸
13. Completion of the IAG sale proper concludes with the replacement of the AMI New Co board with new IAG appointed directors and the registration of the relevant name changes.

Immediate post completion activities:

14. Immediately upon the completion of the IAG sale (but also on the day of completion) the Crown will take control of Southern Response by:
- exercising its powers under the Crown Support Deed to assume direct control of 99.9% of the share capital of Southern Response by the payment of \$100 million,
 - directing Southern Response to record the Minister of Finance and the Minister for Canterbury Earthquake Recovery as shareholding ministers in equal proportions,

⁶ Note that in the rest of this report we will refer to AMI Insurance Limited as Southern Response.

⁷ It is proposed that one single payment of \$380 million will be made by IAG to Southern Response, discharging the separate obligations of IAG to subscribe for \$380 million of new share capital in AMI New Co, and AMI New Co to pay the purchase price for the transferring assets (\$260 million) and repurchase of the initial share capital (\$120 million).

⁸ See footnote 7.

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- replacing the board of Southern Response and its subsidiaries with its own Crown appointed nominees,
 - sanctioning the entry by Southern Response into a share buyback agreement with its former holding company AMI Holdings Limited (**Holdings**) in order to "mop up" the Holding's residual shareholding in Southern Response.⁹
15. The Crown will also:
- as Southern Response's new controlling shareholder, authorise the adoption by Southern Response of a new constitution appropriate for Southern Response's new status as a Crown controlled company;
 - authorise and enter into an amended Crown Support Deed and amended Conditions to the remaining Convertible Preference Shares with Southern Response to provide the new directors assurance of continuing Crown financial support in the event that the assets of the company turn out to be insufficient to cover its liabilities.¹⁰

The Crown's role during completion and in fully establishing Southern Response as a Crown owned company

Completion Day

16. The Crown's role on the completion day may be characterised in the following way:

During completion of the IAG sale

17. During this phase of the completion day the Crown will be called upon to sign certain documents which require the unanimous consent of the shareholders of Southern Response. At this point the Crown will not have taken a controlling stake in Southern Response. However as a result of the operation of the Crown Support Deed the Crown (through the Minister of Finance) currently holds one ordinary share in Southern Response and another special rights share. These transactions require unanimous shareholder endorsement as the directors of Southern Response (that is, the existing board of AMI Insurance Limited) may have an "interest" in each of these transactions and cannot pass the requisite board resolutions without possible challenge unless sanctioned by all the shareholders of Southern Response.¹¹

Immediately following completion of the IAG sale

18. Following completion of the IAG sale the Crown needs to complete a number of steps to take Crown control over Southern Response. This involves:
- exercising certain powers already vested in the Crown by the terms of the Crown Support Deed (for example by paying-up 100 million convertible preference shares and converting them into 1,000,000 ordinary shares of

⁹ This is an agreement to buy back Holdings' residual shares (100 shares) in Southern Response. The actual buy back will take place a few weeks after completion, once the completion balance sheet of Southern Response has been audited. At that stage the directors of Southern Response will be in a position to issue a solvency certificate in respect of Southern Response. The issue of a solvency certificate by the directors of Southern Response is a prerequisite for the completion of the buy-back transaction with Holdings. Once the buy-back happens the Crown will have a 100% ownership interest in the share capital of Southern Response.

¹⁰ The major change here is that the Crown support of up to \$500 million, will be extended from 5 years to 10 years since it is unlikely that all claims and disputes will be settled within the 5 year period.

¹¹ As part of the completion of the IAG sale the Crown will also confirm with IAG the number of comprehensive housing insurance policies that IAG is required to maintain in Christchurch for 3 years following completion. IAG and AMI have been jointly preparing a methodology to confirm this number and that will be used to report on compliance with this undertaking to the Crown in the future.

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Southern Response, so as to secure the Crown a controlling shareholder interest in the company);

- exercising certain powers that only a controlling shareholder of Southern Response can exercise (such as the appointment of new directors and the adoption by Southern Response of a new constitution);
- sanctioning transactions (such as the buy-back agreement and alteration of the conditions attaching to the conditions to the convertible preference shares and the Crown's special rights share) which would not be valid under the Companies Act requirements without shareholder sanction.

After the completion day

19. Southern Response is to become a Crown company under schedule 4 of the Public Finance Act 1989. Cabinet has already given its "in principle" approval to this and the Crown Entity Act restrictions to which it will be subject.
20. Cabinet has also agreed that once the Crown takes control of Southern Response, Southern Response will be:
 - made subject to the Ombudsmen Act 1975 and the Official Information Act 1982;
 - exempted from the operation of the Insurance (Prudential Supervision) Act 2010 ("IPSA") by the issuance of regulations under section 237 (1) (b) of IPSA, as recommended by RBNZ.
21. The final form of:
 - the Orders in Council (for the purposes of making Southern Response subject to schedule 4 of the Public Finance Act 1989 and subject to Ombudsmen Act 1975 and the Official Information Act 1982); and
 - the IPSA regulations (that would deem Southern Response not to be a public entity that carries on insurance business for the purposes of the Insurance (Prudential Supervision) Act 2010);have not yet however been approved.
22. It is proposed that Cabinet be requested to waive the 28 day rule and approve these Orders in Council and the IPSA regulations at its first meeting after the Easter break on 16 April 2012.¹²

Delegations of authority

Reasons for delegation of authority

23. The then Secretary to the Treasury entered into the Crown Support Deed on behalf of the Crown pursuant to the terms of section 65 I of the Public Finance Act 1989 (Investment of Public Monies) and under a delegation from the then Minister of Finance dated 25 January 2005.¹³

¹² This will mean that Southern Response will technically be subject to IPSA for a few days following the date on which the Crown assume direct control of that company. However the RBNZ has provided written advice that it will waive any enforcement or regulatory action for the short period that will elapse between the time when the Crown assumes direct shareholding control of Southern Response and the time that the IPSA regulations are made.

¹³ Under section 65I of the Public Finance Act 1989, Treasury may invest any money held in a Crown bank account or a departmental bank account in any securities that the Minister may approve for the purpose. Under a delegation dated 25

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24. Treasury legal has advised that as the Secretary had delegated authority to enter into the Crown Support Deed on behalf of the Crown, he also had authority to exercise the powers conferred on the Crown under the Crown Support Deed (for example to give or withhold consent which by the terms of the deed requires prior Crown written consent).
25. It is clear however that the Secretary does not have delegated authority to exercise the powers that only a shareholder can exercise where that shareholder is the Crown acting by or through one or more shareholding Ministers. These are powers that derive from the rights attaching to shareholders generally under the Companies Act rather than being solely or mainly derived from the powers conferred on the Crown under the Crown Support Deed.
26. Some (although not all) of the actions that need to be taken by the Crown on completion day relate to the Crown acting through one or more Ministers in their capacity as shareholders, rather than in the exercise of an explicit power conferred on the Crown by the Crown Support Deed.
27. The actions to be taken by the Crown on completion day may be characterised as being largely administrative (for instance the provision of shareholder consent where a board resolution may be open to challenge because some or all of the directors may technically have an "interest" in the transactions being voted on) or with respect to matters that Cabinet has already considered (for example the appointment of Crown nominated directors to Southern Response or the adoption of a new constitution, or amendments to the Crown Support Deed).
28. At this point Treasury has been advised that there will be twelve documents to sign, three of which would (without any delegation) require signing by the Minister of Finance and the Minister for Canterbury Earthquake Recovery. The remaining documents relate to actions that need to be taken by the Crown in relation to the Crown Support Deed, and the shares in AMI that were issued to the Crown acting by and through the Minister of Finance, when the Crown Support Deed was executed in April 2011. Therefore, nine of the twelve documents would in the absence of any delegation require signature by the Minister of Finance alone.
29. Treasury recommends the establishment of delegations as the completion processes require the signing of a number of documents on behalf of the Crown, and the delegations will mitigate the risk of Ministerial unavailability at relevant times, and reduce the administrative burden on Ministers.
30. While it is anticipated that the provision of delegations of authority in this case, would be more convenient for Ministers, Treasury is in a position to provide further detailed briefings if Ministers wish to sign the relevant documents themselves without further delegation.¹⁴ However time frames are tight (see below) and we are conscious that Minister's availability in the period up to Easter may be constrained.

Form of delegation

31. Two forms of delegation are attached, one for the Minister of Finance and one for the Minister for Canterbury Earthquake Recovery.
32. The delegations are expressed in general terms, and not in terms that are specific to the twelve documents identified for signing. The reason for this is that it is possible

January 2005, the Minister of Finance granted authority to the Secretary to the Treasury to approve securities for investment of any money held in a Crown bank account or a departmental bank account.

¹⁴ Note that Treasury is currently in the process of briefing CERA as to the background to these matters, so CERA is in a position to provide its own briefings to the Minister for Canterbury Earthquake Recovery or (in the event of a delegation to the Chief Executive of CERA) to the Chief Executive and/or his sub-delegate.

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(although we think it unlikely) that additional documents or documents that are expressed in different terms may be identified later in the pre-completion phase.

33. The delegations also consent to sub-delegation by the Secretary to the Treasury and the Chief Executive of CERA. The consent to sub-delegation is to mitigate the risk of the Secretary to the Treasury and the Chief Executive of CERA being unable to sign any of the relevant documents on completion day. To address any concerns about the extent of possible sub-delegation, the delegation provides that delegated authority may not be exercised in a manner inconsistent with Cabinet's earlier decisions in relation to AMI.

Timing in relation to the delegation

34. The current completion steps plan for all entities that are to participate in completion runs to some 17 pages. Given that complexity, it has been decided by AMI and IAG to pre-sign all the documents that they have to sign next Monday (2 April) and to put those documents in escrow pending completion on Thursday 5 April. In addition it has been decided that there will be a "dress rehearsal" for completion on next Tuesday 3 April. Treasury considers that both these ideas are sensible.
35. In this context (and assuming that Ministers consider it appropriate to provide the delegations requested) it would be appreciated if the delegations attached could be signed by Ministers and returned to Treasury by close of business on this Thursday 29 March. Treasury (and CERA as regards the Minister for Canterbury Earthquake Recovery) can then brief the Secretary and the Chief Executive (or their nominated sub delegates) this Friday, 30 March so that the documents can be pre-signed and then held in escrow in time for the "dress rehearsal" on Tuesday 3 April.

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 5 April 2012

To: Minister of Finance
Minister of Canterbury Earthquake Recovery

AMI Accounting Impacts

The purpose of this aide memoire is to inform you of:

- (A) the accounting treatment for the sale of AMI's ongoing insurance business (AMI NewCo) to IAG
- (B) the estimated cost to the Crown of the AMI support package over its life based following the sale of AMI NewCo to IAG and reflecting the updated valuation of the Canterbury related earthquake claims retained in SRSL, and
- (C) an updated valuation of the AMI Canterbury earthquake related claims retained in Southern Response Earthquake Services Limited (SRSL) following the sale of AMI NewCo to IAG).

Background

On 7 April 2011 the Government provided financial support to AMI under the Crown Support Deed (CSD) by subscribing for \$500 million convertible called, but unpaid preference shares in AMI. While the Crown did not own AMI, AMI has been consolidated into the financial statements of the Government since the CSD on the basis that the Government had the capacity to direct the operating and governing policies of AMI (through its option to make partial payment and take control of the Board) and is directly impacted by the risks, or benefits from, AMI's operations. The fair value of AMI at 7 April 2011 was \$159 million. In the 2010/11 financial statements of Government an expense of \$335m was recorded to reflect the loss expected based on valuations at that time (being \$494m¹ deferred cost of convertible shares less the fair value of AMI \$159m).

On 16 December 2011 AMI announced the sale of its ongoing insurance business to IAG; that sale is due to complete on 5 April 2012. While the details of the sale process have been communicated to you recently in *TR2012/203 AMI – Post Sale Update*, dated 10 February and *TR2012/564 AMI Update – Moving Towards Completion*, dated 27 March, a summary of the sale process is provided here:

- On completion day SRSL will transfer its on-going insurance business to a subsidiary, AMI NewCo.
- As part of the transfer AMI NewCo will be capitalised with net assets of \$120 million.
- AMI NewCo will be purchased by IAG for \$380 million (after the direct costs of the sale estimated at \$18 million, the net proceeds will be \$362 million).

¹ As the Crown's support package of \$500m was not expected to be paid immediately a discount of \$6million was made to adjust for the time value of money

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- Immediately after completion of the IAG sale the Crown will make a capital injection of \$100 million of the \$500 million existing called but unpaid capital under the terms of the CSD. At that point the Crown will exercise its right under the CSD to assume direct control of 99.9% of the share capital of SRSL and direct SRSL to record the Minister of Finance and the Minister for Canterbury Earthquake Recovery as shareholding ministers in equal proportions.
- SRSL will be listed as a Schedule 4 Company under the Public Finance Act 1989.
- The Crown Support Deed with SRSL will be revised to reflect the change in relationship with the Crown.
- The Crown Support Deed requires that SRSL deposit the proceeds of sale and any other temporarily surplus cash in Crown Securities matching the timing of future payments. Accordingly \$480 million (including the \$100 million capital injection by the Crown on completion date) will be transferred to the Debt Management Office to purchase NZ Government securities on the date of completion.

(A) Accounting treatment for the sale of AMI's ongoing insurance business to IAG

Final audited accounts for AMI are a requirement of the sale process, the final accounts will include a revised valuation of the outstanding claims liability up to the date of sale. The figures presented in this report represent the most up to date information available but may be subject to change on completion of the final accounts.

A gain on sale of approximately \$242 million is estimated for the sale of AMI NewCo (including the sale of the AMI brand) to IAG. The gain on sale is calculated as follows:

	\$m
Sale Proceeds from IAG (gross)	380
Direct costs of sale	(18)
Net Sales Proceeds	362
Less Net Assets of AMI NewCo sold to IAG	120
Estimated gain on sale of AMI NewCo	242

The gain on sale will be recorded as a gain (below OBEGAL) and will reduce the operating deficit in the April Financial Statements of the Government assuming the sale completes in April as planned. The sale will also increase the Government's net worth by \$242 million (de-recognition of AMI net assets of \$120 million and recognition of the \$362 million net sale proceeds from IAG).

Net Debt (a core Crown indicator) will increase by \$100m in April as a result of the \$100 million capital injection by the Crown into SRSL.

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(B) The estimated cost to the Crown of the AMI support package

The following table shows the likely cost of the support package over its life taking into account the expense already recognised in the Financial Statements of the Government in 2010/11.

The 2011/12 forecast includes AMI NewCo operating result up to the expected completion date, 5 April 2012. The forecast also assumes that the risk margin provision (being 14.2% of the central estimate) is released through OBEGAL annually, in proportion to the claims being settled. This is predicated on the forecast assumption that claims are paid at the central estimate.

		Recognition in Crown Operating Balance \$m	Cash payments to AMI \$ m
Recognised in 2010/11 Crown Financial Statements			
Impairment of Investment in AMI		(335)	
losses recognised 2010/11		(20)	
OBEGAL impact		(355)	
Projected Crown impact for 2011/12			
Gain on Sale BAU	242		
Gain on Sale property	8		
Gain (below OBEGAL)	250		
Revenue	261		
Expenditure (including \$146m increase in claims provision)	(422)		
April Increase in Claims valuation	(25)		
OBEGAL impact (deficit increases)	(187)		
4 Outyear forecasts (2012/13 to 2015/16)			
Interest income	40		
Unwind of discounting	(42)		
Expenses	(21)		
Unwind of risk margin	216		
OBEGAL impact (deficit reduces)	194		
Funding			
Initial payment for Crown to AMI Oldco - 2011/12			(100)
Surplus on liquidation/(future cash shortfall)			2
Total cost to Crown / Total funding required		(98)	(98)

While the \$98 million cost is the best estimate of the likely cost of the AMI support package over its life based on current information, there remains considerable uncertainty about the final cost of Canterbury earthquake claims. Any changes in the final costs of Canterbury claim will impact the ultimate cost to the Crown's of the AMI support package.

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(C) Updated valuation of AMI Canterbury earthquake related claims

SRSL will exist to manage the payment of Canterbury earthquake related claims that existed prior to completion of the sale to IAG. All the assets and liabilities relating to SRSL, including the outstanding claims liability and relevant reinsurance receivables will continue to be consolidated into the financial statements of Government as a Crown company under schedule 4 of the PFA 1989.

AMI's actuaries are completing a valuation of outstanding claims liabilities as at the date of sale of AMI NewCo to IAG. The actuary's preliminary findings are that the outstanding claims provision will increase by \$171 million (including \$21 million additional risk margin). This increase has been recognised as follows:

- AMI's February financial results and recent preliminary forecast for Budget 2012 included an allowance for \$100 million of the increase in the cost of claims.
- Allowance was made for an additional \$46 million of corporate and claims handling costs in the recent preliminary forecast for Budget 2012.
- A further \$25 million will need to be included in the final forecast for Budget 2012 to reflect the actuary's latest valuation once it is finalised

This updated valuation has been informed by claims experience and a significant increase in the number of detailed repair assessments (DRAs) completed since the last valuation. The number of detailed repair assessments (DRAs) completed by AMI has increased from approximately 50% of total claims as at October 2011 to over 80% as at February 2012.

The central estimate of the cost of claims has increased by \$150 million (\$171 million including risk margin) due to:

- Estimated repair and rebuild costs increasing, with repair cost estimates coming in higher than the October calculation and rebuild costs increasing due to the significant contingency provided for Technical Category 3 (or blue/green) properties; and
- An increase in the number of out of scope claims, although the average cost of these claims is in line with expectations.

Any further increases in claims expenses (including increases in claims handling costs) will increase the OBEGAL deficit. This would also have flow-on impacts to additional funding that AMI Oldco (Southern Response) would require under the CSD. Additional funding under the CSD will impact net debt (a core Crown indicator).

Maureen Tong, Senior Accountant, Deposit Guarantees Schemes, 917 6169
John Park, Manager, Deposit Guarantees Schemes, 917 6252

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Treasury Report: AMI OldCo — Orders in Council

Date:	10 April 2012	Report No:	T2012/662
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Sign the attached CAB Paper, CAB 100 Form, and Advice Sheets Forward all the documents to the Minister for Canterbury Earthquake Recovery	Wednesday 11 April 2012
Minister for Canterbury Earthquake Recovery (Hon Gerry Brownlee)	Sign the attached CAB Paper and CAB 100 Form Forward all the documents to the Cabinet Office	By 10 am Thursday 12 April 2012
Associate Minister of Finance (Hon Steven Joyce)	Note the contents of this report	None
Associate Minister of Finance (Hon Dr Jonathan Coleman)	Note the contents of this report	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
John Park	Manager, Guarantee Schemes	917 6252(wk)	✓
Stephen Revill	Senior Solicitor	917 6148 (wk)	

Ministers' Office Actions (if required)

Once the Report, CAB Paper, CAB 100 Form, and Advice Sheets have been signed by the Minister of Finance, forward all the documents to the office of the Minister for Canterbury Earthquake Recovery.

Once the Report, CAB Paper and CAB 100 Form have been signed by the Minister for Canterbury Earthquake Recovery, forward the CAB Paper, Advice Sheets, and CAB 100 Form to Cabinet Office.

Enclosure: Yes [Cabinet Paper-AMI-Schedule 4 PFA and Schedule 1 Ombudsmen Act \(Treasury:2267099v1\)](#) [Add to worklist](#)

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10 April 2012

Treasury Report: AMI OldCo — Orders in Council

Executive Summary

This report briefs you on the attached Cabinet Paper which recommends that Cabinet authorise the submission of two Orders in Council to the Executive Council.

On 27 February 2012, Cabinet agreed that AMI OldCo (renamed Southern Response Earthquake Services Limited ("Southern Response")) be added via Orders in Council to Schedule 4 of the Public Finance Act 1989 (the "PFA"), and Schedule 1, Part 2 of the Ombudsmen Act 1975 (the "Ombudsmen Act") [CBC Min (12) 1/7, as confirmed in CAB Min (12) 6/1 refers].

These Orders in Council add Southern Response to Schedule 4 of the PFA, and Schedule 1, Part 2 of the Ombudsmen Act.

Orders in Council — Public Finance Act and Ombudsmen Act

1. In March 2011, AMI Insurance Limited ("AMI") advised the Government that it would be unlikely to have sufficient reinsurance and reserves to cover all claims arising out of the February 2011 earthquakes in Canterbury. Government agreed to provide financial support to AMI via a Crown support deed ("Crown Support Deed") while AMI sought additional capital from new sources. In December 2011, AMI entered an agreement with IAG (NZ) Holdings Limited ("IAG") for IAG to purchase the on-going insurance business of AMI, which will be transferred into a new subsidiary of AMI.
2. Completion of the sale of AMI NewCo to IAG has occurred and the Crown has exercised powers under the Crown Support Deed to take control of AMI and its subsidiaries, including its sole remaining operational subsidiary, CLIC Car Insurance Limited ("CLIC"), a specialist motor vehicle insurer. CLIC has been renamed SR 1 Limited. AMI has been renamed Southern Response Earthquake Services Limited. Its main business will be to manage and settle all claims that remain outstanding against AMI and CLIC (now SR 1 Limited) prior to the completion of the IAG sale, including all insurance claims arising out of the recent Canterbury earthquakes.
3. Southern Response will be a Crown-controlled company listed in Schedule 4 of the PFA, and subject to the Official Information Act 1982.
4. On 27 February 2012, Cabinet agreed that Southern Response be added to Schedule 4 of the PFA, and Schedule 1, Part 2 of the Ombudsmen Act [CBC Min (12) 1/7, as confirmed by CAB Min (12) 6/1].
5. Section 3A(1)(a)(iv) of the PFA authorises the Governor-General, by Order in Council, to add the name of a company to Schedule 4 of the PFA. Section 3A(2) of the PFA provides that an Order in Council may be made under subsection 3A(1)(a)(iv) only if the Governor-General in Council is satisfied, at the time of the making of the Order in Council, that more than 50% of the issued ordinary shares in the capital of the company to which the order relates are held by Ministers of Crown on behalf of the Crown.

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6. Section 3A(1)(b) of the PFA authorises the Governor-General by Order in Council to declare that certain provisions of the Crown Entities Act 2004 ("CEA") will apply to the organisation. Section 32(2)(a) of the Ombudsmen Act authorises the Governor-General, by Order in Council, to add any organisation to Schedule 1, Part 2 of the Ombudsmen Act.
7. The Minister of Finance and the Minister for Canterbury Earthquake Recovery each hold 50% of the issued ordinary shares in the capital of the company.
8. On 27 February 2012, Cabinet also agreed that Southern Response will be subject to sections 139, 150, 153, 161, 162 and 164 of the CEA. The basis for applying sections 139 and 150 of the CEA to Southern Response is that the preparation of an annual report and statement of intent provides Ministers with an opportunity to be involved in the setting of performance expectations on a formal basis.
9. The broad policy basis for applying sections 162 and 164 of the CEA to Southern Response is that Southern Response will be self-funding, and there is no obvious need for Southern Response to enter into any derivative transactions, other than perhaps foreign exchange or forward foreign exchange transactions. If there is any unexpected shortfall in Southern Response's working capital, it will be open to Ministers to approve borrowings under section 160 of the CEA on a case by case basis. It is also for this reason that the Crown Support Deed (in amended and restated form) will be retained to provide Southern Response with "back stop" funding in case there is a shortfall in funding.
10. Southern Response will not be subject to section 163 of the CEA, which imposes restrictions on the giving of guarantees and indemnities. This is because Southern Response will have the power to issue new insurance policies, but only to the extent necessary for the management of insurance claims as a result of the Canterbury earthquakes. Contracts of insurance constitute a type of indemnity, and the application of section 163 of the CEA to Southern Response would require Ministerial oversight of the day to day conduct of Southern Response's claims management business.
11. Cabinet has previously been provided with draft Orders in Council adding Southern Response to Schedule 4 of the PFA and Schedule 1, Part 2 of the Ombudsmen Act 1975. Cabinet noted that the Parliamentary Counsel Office has prepared regulations, attached in draft form to CBC (12) 9 at Annex 2 [CBC Min (12) 1/7, as confirmed in CAB Min (12) 6/1 refers].
12. We will arrange for the following to be provided to Cabinet on 16 April 2012:
 - An Order in Council adding Southern Response to schedule 4 of the Public Finance Act 1989, and applying sections 139, 150, 153, 161, 162 and 164 of the Crown Entities Act 2004 to Southern Response;
 - An Order in Council adding Southern Response to Schedule 1, Part 2 of the Ombudsmen Act 1975.

Recommended Action

We recommend that you:

Minister of Finance

- a **sign** the attached Cabinet Paper, CAB 100 Form, and advice sheets relating to the Public Finance (Southern Response Earthquake Services Limited) Order 2012 and the

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Ombudsmen Act (Schedule 1 — Southern Response Earthquake Services Limited) Order 2012; and

- b **forward** the attached Cabinet Paper, CAB 100 Form, and advice sheets relating to the Public Finance (Southern Response Earthquake Services Limited) Order 2012 and the Ombudsmen Act (Schedule 1 — Southern Response Earthquake Services Limited) Order 2012 to the Minister for Canterbury Earthquake Recovery by 11 April 2012;

Minister for Canterbury Earthquake Recovery

- c **sign** the attached Cabinet Paper and CAB 100 Form relating to the Public Finance (Southern Response Earthquake Services Limited) Order 2012, the Ombudsmen Act (Schedule 1 — Southern Response Earthquake Services Limited) Order 2012; and
- d **forward** the attached Cabinet Paper, advice sheets, and CAB 100 Form relating to the Public Finance (Southern Response Earthquake Services Limited) Order 2012 and the Ombudsmen Act (Schedule 1 — Southern Response Earthquake Services Limited) Order 2012 to Cabinet Office by 12 April 2012.

John Park
Manager, Guarantee Schemes

Hon Bill English
Minister of Finance

Hon Gerry Brownlee
Minister for Canterbury Earthquake Recovery

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Treasury Report: Southern Response Earthquake Services Limited/SR 1 Limited — Regulations

Date:	10 April 2012	Report No:	T2012/663
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Sign the attached CAB Paper, CAB 100 Form, and Advice Sheet Forward all the documents to Cabinet Office	By 10 am Thursday 12 April 2012
Minister for Canterbury Earthquake Recovery (Hon Gerry Brownlee)	Note the contents of this report	None
Associate Minister of Finance (Hon Steven Joyce)	Note the contents of this report	None
Associate Minister of Finance (Hon Dr Jonathan Coleman)	Note the contents of this report	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
John Park	Manager, Guarantee Schemes	917 6252(wk)	✓
Stephen Revill	Senior Solicitor	917 6148 (wk)	

Ministers' Office Actions (if required)

Once the Report, CAB Paper, CAB 100 Form, and Advice Sheet for the Insurance (Prudential Supervision) Act (Southern Response Earthquake Services Limited and SR 1 Limited) Regulations 2012 have been signed by the Minister of Finance, forward all documents to the Cabinet Office.

Provide copies of all documents to the Minister for Canterbury Earthquake Recovery and the Associate Ministers of Finance for their information.

Enclosure: Yes [Cabinet Paper-AMI-Insurance \(Prudential Supervision\) Act 2010 Regulations \(Treasury:2281559v1\)](#) [Add to worklist](#)

IN-CONFIDENCE

10 April 2012

Treasury Report: Southern Response Earthquake Services
Limited/SR 1 Limited — Regulations

Executive Summary

1. On 27 February 2012, Cabinet agreed that Southern Response and CLIC Car Insurance Limited (renamed SR 1 Limited ("SR1L")) be declared via regulations to be public entities (within the meaning of section 5(1) of the Public Audit Act 2001) to which section 8(2)(d) of the IPSA applies [CBC Min (12) 1/8 as confirmed by CAB Min (12) 6/1 refers]. The effect of this declaration is that Southern Response and SR1L will be considered, for the purposes of IPSA, companies which do not carry on insurance business in New Zealand. This means that they will not be subject to the requirements of IPSA.
2. Section 237(1)(b) of IPSA authorises the Governor-General, by Order in Council, and on the advice of the Minister given in accordance with a recommendation from the Reserve Bank of New Zealand ("Reserve Bank"), to make regulations via Order in Council declaring a public entity to be an entity to which section 8(2)(d) of IPSA applies. Section 8(2)(d) of IPSA provides that a person does not carry on insurance business in New Zealand for the purposes of IPSA if the person is a public entity (within the meaning of section 5(1) of the Public Audit Act 2001) that is declared by regulations to be an entity to which section 8(2)(d) of IPSA applies.
3. The Reserve Bank has recommended that the Minister of Finance make regulations declaring Southern Response and SR1L to be public entities which are not carrying on insurance business in New Zealand for the purposes of IPSA.
4. We attach a letter from the Reserve Bank confirming that the attached Cabinet paper reflects the recommendation given by the Reserve Bank that the regulations be made.
5. Cabinet has previously been provided with a draft Order in Council declaring Southern Response and CLIC (now SR1L) to be public entities which are not carrying on insurance business in New Zealand for the purposes of IPSA. Cabinet noted that the Parliamentary Counsel Office has prepared the regulation, attached in draft form to CBC (12) 8 [CBC Min (12) 1/8, as confirmed in CAB Min (12) 6/1 refers].
6. We will arrange for the Order in Council declaring Southern Response and SR1L to be public entities which are not carrying on insurance business in New Zealand for the purposes of IPSA to be provided to Cabinet on 16 April 2012.
7. A Cabinet Paper, Advice Sheet and Cab 100 Form relating to the Order in Council are attached for your signature.

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Recommended Action

We recommend that you:

- a **sign** the attached Cabinet Paper, CAB 100 Form, and advice sheet relating to the Insurance (Prudential Supervision) Act (Southern Response Earthquake Services Limited and SR 1 Limited) Regulations 2012;
- b **forward** the attached Cabinet Paper, CAB 100 Form and advice sheet relating to the Insurance (Prudential Supervision) Act (Southern Response Earthquake Services Limited and SR 1 Limited) Regulations 2012 to Cabinet Office by 12 April 2012.

John Park
Manager, Guarantee Schemes

Hon Bill English
Minister of Finance

	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	TOTAL
Cash Flows From Operations																0
Insurance Premiums																0
Rental income received																0
Investment Income Received																0
	1,708	1,615	1,522	1,424	1,305	1,188	1,070	952	834	716	595	477	358	285	166	14,213
	1,708	1,615	1,522	1,424	1,305	1,188	1,070	952	834	716	595	477	358	285	166	14,213
Claims Paid																0
Reinsurance Recoveries Catastrophe	(66,694)	(66,694)	(66,694)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(72,932)	(1,075,271)
EQC Funds Advanced	22,014	22,015	22,015	16,643	16,643	16,643	16,643	16,643	16,643	16,643	16,643	16,643	16,643	16,643	16,643	265,761
EQC Funds Received	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Reinsurance Recoveries Aggregate	750	750	750	850	850	850	850	850	850	850	850	850	850	850	850	12,450
Wages	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other CME Expenses	(1,305)	(1,264)	(3,532)	(1,939)	(1,250)	(4,308)	(1,251)	(1,302)	(1,279)	(2,107)	(1,195)	(1,092)	(1,095)	(1,030)	(1,059)	(21,949)
Taxation	(1,028)	(988)	(948)	(948)	(916)	(937)	(987)	(930)	(906)	(1,038)	(895)	(894)	(935)	(871)	(848)	(14,127)
	(46,263)	(46,180)	(48,409)	(59,383)	(57,606)	(57,685)	(57,677)	(57,672)	(57,625)	(58,585)	(57,470)	(57,426)	(57,469)	(57,340)	(57,346)	(833,137)
Cash Flows From Operations	(44,556)	(44,565)	(46,887)	(56,359)	(56,301)	(56,497)	(56,607)	(56,720)	(56,791)	(57,869)	(56,875)	(56,949)	(57,111)	(57,055)	(57,181)	(818,923)
Cash Flows From Investing																0
Short Term Deposits																0
Government and Corp Bonds																0
Sale of Investment Properties																0
Sale of Land and Buildings																0
Sale of fixed assets	(29)	(12)	(102)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(258)
Purchase of fixed assets																0
Cash Flows From Investing	(29)	(12)	(102)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(258)
Cash Flows From Financing																0
Capital From Crown Receivable																0
Capital Contribution from Uncalled Capital	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash Flows From Investing	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
NET CASH MOVEMENT	(44,585)	(44,567)	(46,989)	(56,970)	(56,311)	(56,507)	(56,618)	(56,730)	(56,801)	(57,879)	(56,885)	(56,959)	(57,121)	(57,066)	(57,191)	(819,181)
OPENING CASH BALANCE	819,611	775,026	730,459	683,470	626,500	570,189	513,682	457,064	400,333	343,532	285,653	228,768	171,808	114,687	57,621	819,611
CLOSING CASH BALANCE/(SHORTFALL)	775,026	730,459	683,470	626,500	570,189	513,682	457,064	400,333	343,532	285,653	228,768	171,808	114,687	57,621	430	430
SHORTFALL AMOUNT	0	0	0	0	0	0	0	0	0	0	0	0	0	0	22,000	22,000
QUARTERLY SHORTFALL AMOUNT	0															22,000

Private and Confidential



Deed of Amendment and Restatement

(relating to a Crown Support Deed and
Convertible Preference Shares Conditions)

Her Majesty the Queen in right of New Zealand

AMI Insurance Holdings Limited

Southern Response Earthquake Services Limited



DEED OF AMENDMENT AND RESTATEMENT (RELATING TO A CROWN SUPPORT DEED AND CONVERTIBLE PREFERENCE SHARES CONDITIONS)

Date:

Time:

PARTIES

Her Majesty the Queen in right of New Zealand acting by and through the Minister of Finance (*Crown*)

AMI Insurance Holdings Limited (*AMI Holdings*)

Southern Response Earthquake Services Limited (formerly AMI Insurance Limited) (*Southern Response*)

BACKGROUND

- A The Crown, AMI Holdings and AMI Insurance Limited (now Southern Response) entered into the Crown Support Deed on 7 April 2011 (*Crown Support Deed*) under which the Crown agreed to provide the then AMI Group with support on certain terms and conditions.
- B As contemplated by clause 2 of the Crown Support Deed, the Crown subscribed for 500,000,000 convertible preference shares in AMI Insurance Limited (now Southern Response), which were issued on a fully called, but unpaid, basis by AMI Insurance Limited (now Southern Response) to the Crown on 13 April 2011 pursuant to a Subscription Agreement between the Crown and AMI Insurance Limited (now Southern Response) dated 7 April 2011, the rights, privileges and limitations attaching to which were set out in the schedule to that agreement (*Conditions*).
- C The Crown, AMI Holdings and Southern Response have agreed:
- (i) pursuant to clause 19.6 of the Crown Support Deed, to amend and restate the Crown Support Deed:
 - (a) to set out the current terms and conditions on which the Crown agrees to continue to provide the Southern Response and its subsidiaries with support;
 - (b) so that AMI Holdings will cease to be party to the Crown Support Deed; and
 - (ii) pursuant to clause 6.3 of the Conditions, to amend and restate the Conditions.



DEED OF AMENDMENT AND RESTATEMENT

THE PARTIES AGREE as follows:

1 INTERPRETATION

1.1 Definitions

In this Deed, unless the context requires otherwise, capitalised terms shall have the meanings given to them in the Crown Support Deed, and any capitalised term not so defined shall have the meanings set out below:

- (a) *Amended and Restated Conditions* means the amended and restated Conditions in the form attached to this Deed in Schedule Two;
- (b) *Amended and Restated Crown Support Deed* means the amended and restated Crown Support Deed in the form attached to this Deed in Schedule One; and
- (c) *Effective Date* has the meaning given to that term in clause 2.

1.2 Construction

In this Deed, unless the context requires otherwise:

- (a) *Headings*: headings are for convenience only, and do not affect interpretation;
- (b) *Sections, Clauses and Schedules*: a reference to a Section or a clause or Schedule is a reference to a Section or clause in, or Schedule to, this Deed;
- (c) *Singular and plural*: the singular includes the plural and the converse;
- (d) *Particular party or person*: a reference to a particular party or person includes that party's or person's executors, administrators, successors, substitutes and assigns;
- (e) *Deed or document*: a reference to a deed or a document is to the deed or document as amended, novated, supplemented or replaced from time to time; and
- (f) *Legislation*: a reference to legislation or to a provision of legislation includes any amendments and re-enactments of it, a legislative provision substituted for it and a statutory regulation, rule, order or instrument made under or issued pursuant to it.

2 EFFECTIVE DATE

This Deed comes into effect from the date and time of execution as indicated at the front of this Deed (the *Effective Date*).



DEED OF AMENDMENT AND RESTATEMENT

3 RETIREMENT OF AMI HOLDINGS FROM CROWN SUPPORT DEED

The parties agree that, with effect from the Effective Date:

- (a) AMI Holdings will cease to be a party to the Crown Support Deed (including as amended and restated pursuant to this Deed); and
- (b) AMI Holdings will be released from all of its obligations, and will cease to have any rights, under the Crown Support Deed (including as amended and restated pursuant to this Deed).

4 AMENDMENT AND RESTATEMENT OF CROWN SUPPORT DEED

The parties to this Deed agree that, with effect from the Effective Date:

- (a) the Crown Support Deed shall be and is hereby amended to be in the form of the Amended and Restated Crown Support Deed; and
- (b) the Crown Support Deed as amended and restated by clause 4(a) of this Deed will continue in full force and effect, and all references in any other documents between them to the Crown Support Deed will be a reference to the Amended and Restated Crown Support Deed.

5 AMENDMENT AND RESTATEMENT OF THE CONDITIONS

The parties agree that, with effect from the Effective Date:

- (a) the Conditions shall be and are hereby amended to be in the form of the Amended and Restated Conditions; and
- (b) the Conditions as amended and restated by clause 5(a) of this Deed will continue in full force and effect, and all references in any other documents between them to the Conditions will be a reference to the Amended and Restated Conditions.

6 REPRESENTATIONS

The representations in clauses 8.1(a), 8.1(b), 8.1(c), 8.1(d), 8.1(e), 8.1(f) and 8.1(k) of the Crown Support Deed are deemed to be made by each of AMI Holdings and Southern Response on the date of this Deed by reference to the facts and circumstances then existing and as if every reference in any of those representations to "this Deed" were a reference to this Deed.

7 COUNTERPARTS

This Deed may be executed in two or more counterparts, each of which will be deemed to be an original, but all of which together shall constitute one and the same instrument.



DEED OF AMENDMENT AND RESTATEMENT

8 GOVERNING LAW

This Deed will be governed by and is to be construed in accordance with New Zealand law.

RELEASED UNDER THE
OFFICIAL INFORMATION ACT



DEED OF AMENDMENT AND RESTATEMENT

EXECUTED AND DELIVERED as a deed by:

Gabriel Makhoul, Secretary to the Treasury,)
for and on behalf of **Her Majesty the Queen in**)
right of New Zealand under delegation for the)
Minister of Finance in accordance with section 28 of)
the State Sector Act 1988 in the presence of:)

Witness' name:

Witness' occupation:

Witness' address:

Southern Response Earthquake Services
Limited by:

Director
Name:

Director
Name:

AMI Insurance Holdings Limited by:

Director

in the presence of:

Name:

Occupation:

Address:

Private and Confidential



SCHEDULE ONE: AMENDED AND RESTATED CROWN SUPPORT DEED

Crown Support Deed

Her Majesty the Queen in right of
New Zealand

Southern Response Earthquake Services Limited

RELEASED UNDER THE
OFFICIAL INFORMATION ACT



SCHEDULE ONE: AMENDED AND RESTATED CROWN SUPPORT DEED

CROWN SUPPORT DEED

Date: 7 April 2011, as amended and restated on

2012

PARTIES

Her Majesty the Queen in right of New Zealand acting by and through the Minister of Finance (*Crown*)

Southern Response Earthquake Services Limited (formerly AMI Insurance Limited) (*Southern Response*)

BACKGROUND

- A As a result of the Canterbury earthquakes between September 2011 and February 2012, AMI Insurance Limited (now Southern Response) received claims for damage estimated at \$1.8 billion. AMI Insurance Limited's then sole shareholder, AMI Holdings, requested the Crown's support as it was concerned that AMI Group's reserves, reinsurances and investments would not be sufficient to cover all claims under AMI Insurance Limited's policies resulting from the recent Canterbury earthquakes.
- B The Crown, AMI Holdings and AMI Insurance Limited entered into the Crown Support Deed on 7 April 2011 under which the Crown agreed to provide the then AMI Group with support on certain terms and conditions.
- C AMI Insurance Limited subsequently agreed to sell its non-earthquake related business to IAG, and that sale was completed on 5 April 2012. From that date Southern Response is required to operate as a run-off insurer in relation to Covered Claims, and is otherwise intended to operate its business consistent with normal commercial and financially prudent principles (including with respect to its cost structures).
- D The Crown recognises that there continues to be a significant level of uncertainty as to the actual amount required to cover all Covered Claims. Because of that uncertainty there remains the potential for a shortfall between:
- (i) Southern Response's reserves, reinsurances and investments; and
 - (ii) Southern Response's obligations in respect of the Covered Claims.
- E The restatement of the Deed sets out a mechanism by which the Crown will fund Southern Response, if required, to meet any such eventual shortfall to assist Southern Response to discharge its obligations in respect of the Covered Claims, but only after Southern Response has had recourse to the Group's re-insurance, reserves and investments.
- F However, the Crown and Southern Response also recognise that: