



BELL GULLY

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Welcome to the Spring 2008 issue of *Financial Services Quarterly*, a review of current legal issues in the financial sector.

Each quarter, we summarise recent issues and preview upcoming developments under these headings:

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Crown Deposit Guarantee Scheme - an overview

In response to similar initiatives by governments around the world, the New Zealand Government announced a deposit guarantee scheme on 12 October 2008. A further announcement of a wholesale funding guarantee facility followed on 1 November 2008.

Territorial scope provision of the Financial Advisers Act

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A commentary on what led to the current state of debt capital markets, and what the future is expected to hold.

The Personal Property Securities Act 1999 and trusts – when is an interest under a trust a security?

In this article, the author considers the conflict that arose when an insolvent debtor gave a security interest over all its property, which included property held on trust.

Assignment of choses in action

Dr Roger Fenton assesses the effect of the Property Law Act 2007 on the assignment of choses in action.

In the courts

Beware: an unexpected outcome from common subordination wording

The High Court has determined that a payment made to a subordinated creditor by a third party need not be turned over to the senior creditor, notwithstanding a clause in the deed of subordination intending to achieve that outcome.

This case¹ was brought by the senior of two financiers that had lent money to three joint venture companies. The financiers and the borrowers entered into three deeds of priority in respect of the three joint ventures.

When a dispute arose between two of the joint venture companies, High Court proceedings were settled. The consent memorandum recorded that a fund realised from the sale of land that was not included as part of the security taken by the financiers should be paid into a solicitor's trust account for the purpose of making a payment to the junior creditor. The senior creditor was not party to the arrangements and its consent was not sought.

The solicitors received \$1.2 million and paid it to the junior creditor. It was accepted that the payment was made on behalf of certain guarantors.

When the junior creditor refused to pass the payment on to the senior creditor, the senior creditor applied for summary judgment that, pursuant to the terms of the deed of priority, the junior creditor hold the \$1.2 million on trust for the senior creditor and pass it on.

Interpretation of the document

None of the security documents related to the land that was sold to pay the junior creditor, so clause 4 of the deeds of priority (which regulated the order of payments where the mortgagors' assets were realised) did not apply.

The issue therefore came down to interpretation of clause 7 of the deeds of priority, which provided:

"...the Second Securityholder's Secured Money shall be subordinate and subject in right of payment, to the extent and in the manner hereinafter set forth, to the prior payment in full of the First Securityholder's Secured Money:

7.1 No Repayment of Subordinated Debt

The Mortgagor shall not (without the prior written consent of the First Securityholder) pay any part of the Second Securityholder's Secured Money to the Second Securityholder unless and until payment in full of the whole of the First Securityholder's Secured Money has been made...

7.3 Payments Held on Trust

Any payment made to the Second Securityholder, whether voluntarily or in any other circumstances, by or on account of the Mortgagor (including by way of credit or otherwise howsoever) in breach of the foregoing provisions will be held by the Second Securityholder in trust for and to the order of the First Securityholder."

Senior creditor's argument

When the junior creditor received and retained the payment, it did so in breach of its obligations under the deeds of priority. The payment fell within clause 7.3 and so the junior creditor received the money and continued to hold it on trust for the senior creditor.

Further, clause 7.1 prohibited the mortgagors from making any payments to the junior creditor unless and until the senior creditor had been paid in full.

¹ *Westpac New Zealand Limited v Auckland Finance Limited* High Court, Auckland CIV 2008-404-002431

Finally, clause 7.3 required the junior creditor to hold on trust for the senior creditor any payment it received from the mortgagors.

Junior creditor's argument

The factual matrix needed to be taken into account. At the time the contract was entered into, nobody considered that there was a possibility that funds to reduce the junior creditor's loans would come from a development that was not subject to the securities.

The deeds of priority had been prepared carefully by the senior creditor. If there was any ambiguity, then the principle of *contra proferentum* applied.

The words "to the extent and in the manner hereinafter set forth" were important. The introductory passage to clause 7 did not *per se* impose any obligation to any party to the deed. The subsequent details referred specifically to the parties and set out their respective obligations.

If the senior creditor's interpretation of clause 7 was correct, then clause 4 was unnecessary, as the senior creditor could receive its entire entitlement through the operation of clause 7.

The decision

The judge determined that the outcome came down to interpretation of clause 7, stating that if the consequences of any particular interpretation impugn common-sense, then any available alternative interpretation should be considered.

As the senior creditor had prepared the documents very carefully, it presumably intended every clause, phrase and word to have meaning. If the result of a particular interpretation was to exclude a clause, or phrase, or word, then it would be unlikely that the intention of the parties was recognised in that interpretation.

Clause 7 begins with a statement setting out the agreement of subordination. It does not impose any obligation on any party.

The words "to the extent and in the manner hereinafter set forth" indicate that what follows was intended to qualify the basic statement of intent.

Clause 7.1 imposes an obligation on the mortgagor not to pay any part of the junior creditor's secured money until the senior creditor's secured money has been totally repaid, unless the senior creditor consents.

Clause 7.3 then imposes an obligation on the junior creditor to hold any payment made to it "in breach of the foregoing provisions" of clause 7 on trust for the senior creditor. The only foregoing provision that placed an obligation on any party to the deed to do anything was clause 7.1. Therefore, the junior creditor was only required to hold payments on trust where there had been a breach of the obligation imposed on the mortgagor under clause 7.1.

Thus, the judge interpreted the clause to mean that if the mortgagor (without the senior creditor's consent) pays to the junior creditor any part of the junior creditor's secured money before payment in full of the whole of the senior creditor's secured money, then the mortgagor, having breached its obligations under clause 7.1, puts the junior creditor in a position where it must hold any such money on trust for the senior creditor. This applies whether the mortgagor makes the payment personally or whether payment is made on its behalf.

The judge did not consider that this interpretation impugned commercial common-sense.

The conclusion reached was that clause 7 had been drafted to permit a third party to reduce the indebtedness of the mortgagor with the junior creditor, without the funds being transferred to the senior creditor. Accordingly, the application for summary judgment was dismissed.

*Key issue: Senior lenders should take care to ensure that the turnover clauses in subordination deeds are broadly drafted to apply to money received from the borrower **and** money received from its third parties in connection with the junior debt*

Vendor PMSI holder entitlement to be reconsidered

A decision determining how to quantify amounts owed to a PMSI holder when the purchaser goes into receivership (summarised in the Winter 2008 issue of [Financial Services Quarterly](#)) is to be reconsidered.

The decision in question¹ was about how to calculate the amount payable to the vendor purchase money security interest (**PMSI**) holder ahead of the general security holder. The case was brought by the receivers, who argued that the onus was on the vendor to identify the goods it had supplied and for which it had not been paid. This was not possible because each item of goods supplied was not separately identifiable from each other item. The receivers argued that, therefore, the security was worthless.

The judge decided that the amount owed to the vendor was calculated as the cost of sales to the purchaser in the period following registration of the PMSI, less amounts paid by the purchaser to the vendor during that period.

An application was made by the supplier² for recall of the judgment on the following two issues:

Marshalling

The supplier argued that the receivers were obliged to apply the doctrine of marshalling and apportion the proceeds of the receivership in a manner that recognised the supplier's security interest over some of the goods. It was established that the supplier's PMSI had priority over the general security holder's interest. The supplier argued that on that basis, the receivers should not have satisfied the general security holder's indebtedness from the assets that were charged to the supplier.

In response, the receivers argued that the doctrine of marshalling does not extend to directing which assets should be realised, and that when marshalling applies, equity intervenes after realisation by the senior creditor to ensure that the junior creditor is left no worse off than if a different sequence of realisation had applied.

The judge determined that:

- the doctrine does not affect the quantification of what is covered by a security interest but preserves the right to recovery of one creditor over another where there is a shortfall;
- the doctrine can't be used to increase the amount owed to the supplier;
- in enforcing its security, the supplier had to be prepared to make out its value; and
- the absence of any challenge by the receivers would not have made the PMSI any more valuable.

Section 293 Companies Act

The supplier argued that the court's reliance on section 293 of the Companies Act (which relates to liquidators acting on behalf of unsecured creditors) was incorrect, because the issue is between two secured creditors, not a secured creditor and an unsecured creditor.

The judge agreed that drawing on section 293 as an analogy for what should occur under the Personal Property Securities Act risked compromising the rights of unsecured creditors under section 293. As a result, it was determined that justice required that the matter be reconsidered.

The issue for re-consideration was identified as how to find an appropriate method of quantifying the value of the PMSI that is consistent with the findings that:

¹ *Re Service Foods Manawatu Limited (in receivership and liquidation): New Zealand Associated Refrigerated Food Distributors Limited v Simpson and Walton* High Court, Wellington, CIV 2007-485-1563, 24 April 2008

² *New Zealand Associated Refrigerated Food Distributors Limited v Simpson and Walton* High Court, Wellington, CIV 2007-485-1563, 6 May 2008

- the supplier is obliged to identify the goods supplied and not paid for after perfection of the PMSI, but is not obliged to identify individual items of stock; and
- the rule in *Clayton's* case is to apply to the sequence of payments.

We will update progress on this case in future issues of *Financial Services Quarterly*.

Official Assignee's application to have trust declared a sham fails

This case¹ was an appeal made by the Official Assignee against the High Court's decision to decline its application to have a family trust declared a sham.

A previous bankrupt purchased a house as agent for a yet to be created trust. The trust was later settled with the previous bankrupt's children as the beneficiaries and with an independent person and his partner's mother as the trustees. The property was registered in the names of the trustees.

The property was later transferred to the previous bankrupt, who borrowed money and carried out renovations on the house. The trust purchased a further property and the initial property was sold, subsequent to which, the previous bankrupt was again bankrupted.

The Official Assignee (**OA**) claimed that the new property was in reality the property of the bankrupt and should be available to his creditors.

The OA argued that the trust was a sham, and the following questions were considered:

1. Is common intention necessary between a settlor and trustees before a sham can be found?
2. Can a valid trust become a sham?

Question one

Arguing the first point, the OA claimed that it was not necessary to prove common intention, even though the majority of overseas cases firmly favoured the requirement that common intention was to be shown.

The court drew the distinction between bilateral trusts (where the trustee is separate from the settlor) and unilateral trusts (where the trust is settled and managed by the same person). The court said that this requirement is important in cases of a bilateral trust, but fades in the case of a unilateral trust.

The court decided that the important question prior to this argument was whether common intention should be ascertained *objectively* or *subjectively*. The conclusion was that it must be *subjectively*, because otherwise exaggerated weight would be placed on the objective appearance of a transaction.

This view was tempered by the court, which said that it would only look behind a transaction's ostensible validity if there is a "good reason" to do so, and that "good reason" is a high threshold, which is necessary in order to promote commercial certainty.

Question two

Arguing the second point, the OA attempted to show that the trust had become a sham by the time the second property had been acquired.

Relying on New Zealand precedent², the court determined that once a trust is validly created, the beneficiaries have an interest in the trust property that cannot easily be undone. Unless the later appearance of the sham can be traced back to the creation of the trust, the trust remains valid.

The court noted a possible exception to this, being when an item of property is later transferred to the trust, the trust could be a sham with respect to that property only, but the remainder of the trust would remain valid.

Distinction between sham trusts and alter ego trusts

The court considered the relationship between sham trusts and alter ego trusts and described an alter ego trust as one where the controller is deemed to have effective control over the trust and/or the trust property. The control is such that it overrides the discretion of the trustees and makes trust property "in reality" the de-facto property of the controller.

¹ *Official Assignee v Wilson* [2008] 3 NZLR 45

² *MARAC Finance Limited v Virtue* [1981] 1 NZLR 586

The court determined that, unlike a sham trust, an alter ego trust is intended to be a genuine trust. It further agreed with the approach of the High Court in using the alter ego arguments to help to establish whether or not a sham existed.

Decision

On the facts, the court determined on a subjective basis that the bankrupt wished to establish a trust. The documentation was consistent with his subjective intention to create a trust. The trust was not a sham, and the OA's appeal was dismissed.

What we can take from this decision

- A court may look behind the objective face of a trust and examine the subjective intent in order to determine whether it's a sham. However, in order to preserve commercial certainty, it will not do this without "good reason".
- Once a trust is validly created, it will become difficult to unwind it because of the interests of the trust's beneficiaries. This is a high threshold given the evidence presented in this case.
- This decision may reflect an emerging difference in philosophy between the New Zealand courts and the Australian courts. In a recent decision of the High Court of Australia, Justice Kirby stated that there should be "a principled liberation of the Court from constraints imposed by taking documents and conduct solely at face value" and argued that substance should prevail over form.

Guarantee need not be a deed, so one director can sign

This case was an application by a guarantor to set aside a statutory demand under section 290 of the Companies Act.

An insurance company incorporated a factoring company to reduce cash flow risks associated with insurance claims.

One of the insurance company's directors arranged for his company to lend the factoring company \$1 million. A condition of the loan required the insurance company and each of its shareholders to guarantee repayment.

When the factoring company failed to repay the loan, the lender demanded payment from the insurance company under the guarantee.

The insurance company argued that it was not liable under the guarantee because it was not properly executed. It submitted that the guarantee was a deed and as a result, under s180(1)(a) of the Companies Act it should have been executed by two directors and in fact it had only been executed by one.

In the alternative, the insurance company argued that if the guarantee was not a deed, the director who signed it did not have the express or implied authority required by s 180(1)(b), because the shareholders resolution was not properly executed (two of the shareholders had their attorney sign on their behalf and no powers of attorney were produced in evidence).

The court decided that:

- There is no general requirement at law that a guarantee be in the form of a deed (only that it be in writing). In this case, there was proper consideration to make the guarantee binding as a contract - it is well established that a lender's agreement to supply further funds to the debtor and forbearance to sue can constitute valid consideration to render a guarantee contract legally binding.
- Accordingly, the document could be validly executed by a person acting under the guarantor's express or implied authority. Irrespective of whether the shareholders' resolution was properly executed, it was clear that the director who signed had actual authority from all other shareholders to enter into the guarantee because each shareholder had signed at least one of the documents establishing the company's liability to guarantee the loan.

The application to set aside the respondent's statutory demand was declined.

Debtor's forgery attributed to lender

A debtor who forged his mother's signature on a mortgage over her property was found to have acted as the lender's agent in doing so.

This case¹, heard in the Supreme Court, upheld the Court of Appeal's decision to remove a registered mortgage.

A lender agreed to advance a loan with security provided by way of a registered mortgage over the borrower's parents' property.

The lender's solicitor prepared the relevant documentation and forwarded it to the borrower for execution and return. The borrower had his father sign the mortgage, but, knowing his mother was unlikely to agree to sign, forged her signature instead.

The documents were not properly witnessed or dated so the lender's solicitor returned them to the borrower to remedy these issues. The lender's solicitor was not aware of the forgery and made no investigation into the circumstances of the witnessing.

When the dated and witnessed documents were returned, the lender's solicitor registered the mortgage.

Subsequently, the borrower failed to make payments due to the lender, and the lender sought to exercise its power of sale of the mortgaged property.

The borrower's mother claimed that, because her son had forged her signature, the mortgage was indefeasible and should be removed from the register.

The issue for consideration by the court was, with the forgery exception in mind, was the borrower expressly or impliedly appointed to act as the lender's agent and, if so, did he commit fraud in the course of that agency?

The Supreme Court determined that:

- The borrower was entrusted with the task of obtaining his parents' signatures for the lender and was therefore acting as the lender's agent for that purpose.
- Although the lender did not actually authorise the forgery, the fraud was not beyond the scope of the agency.
- The critical fact was that the fraud took place to achieve the very thing the borrower was asked by the lender to do.

The conclusion was that the forgery was committed in the course of the borrower's agency for the lender, and, as a result, the lender did not have indefeasible title.

The Supreme Court upheld the Court of Appeal's decision to dismiss the lender's appeal against the order to remove the mortgage from the title.

¹ *Nathan v Dollars & Sense Limited* 2 [2008] NZLR, 557

Guarantor's argument that lender's conduct misleading and deceptive fails

A guarantor unsuccessfully argued that the lender's conduct was misleading and deceptive when it entered into the loan documents, and that it ought not to have advanced a third loan to the borrower.

In this case¹, the lender advanced a loan to a company (the **borrower**). The loan agreement contained a guarantee from the director of the borrower. A trust established for the benefit of the director owned the shares of the borrower (the **guarantor**).

The borrower failed to make payments due under the loan and the lender attempted to recover the loan by selling the secured property. When it failed to find a buyer, the lender sought payment of the outstanding amount from the guarantor, applying for summary judgment against him.

The guarantor argued that:

- while he knew he was giving a guarantee, he thought the guarantee was a "shortfall" guarantee, meaning that the Lender could only seek payment from him of any shortfall remaining after sale of the secured property; and
- in obtaining the guarantor's signature on the loan documentation, the lender's conduct was misleading and deceptive in terms of section 9 of the Fair Trading Act.

Misleading and deceptive conduct

The guarantor argued that the guarantee was "buried deep within the contract for the loan advance", "a complex and lengthy legal document". He was "unaware of it and nothing was done to draw his attention to it or to advise him to seek independent advice."

It seems the lender sent the documents to the guarantor with a basic cover letter asking him to sign both as guarantor and as director of the borrower.

Rejecting this argument, the judge noted that there had been two previous loan agreements, the terms of both of which were identical to the third loan agreement in question, except that the guarantor was joined by the other trustees as guarantors of the first two. In respect of both previous loan agreements, the guarantor had explicitly waived his right to independent advice.

There was also evidence that the lender and the guarantor had discussed the guarantee at a meeting shortly before the documentation was sent to the guarantor for signing.

Noting that the guarantor was not a "little old lady unfamiliar with commercial matters" and that the guarantee was in conventional terms, the judge found that there was no misleading or deceptive conduct on behalf of the lender.

Duress

The guarantor also argued that, because the borrower had been unable to repay the second loan, it had been obliged to enter into the third one, whereas the lender ought to have taken enforcement action against the borrower at that time.

The judge considered that it was the lender who had little alternative but to offer the third loan when the borrower became unable to repay the second one, rather than the other way around.

Determining that there was nothing unconscionable about the lender's conduct, the judge granted summary judgment against the guarantor.

¹ *Armstrong & Anor v Morrison* High Court, Napier 12 August 2008 CIV 2008-441-276

All obligations mortgages unlikely to incorporate terms of separate loan agreements

In a case brought by a lender against a solicitor who failed to register a mortgage signed by a fraudster, the Court of Appeal has decided that the terms of the separate loan agreement were not incorporated into the all obligations mortgage¹.

A lender agreed to lend money against security over a property purported to be owned by the borrower, who turned out to be a fraudster. In a solicitor's certificate provided to the lender, the lender's solicitor undertook to register the mortgage "promptly". The lender advanced the loan to the fraudster, but it was not until a couple of months later that the lender's solicitor lodged the mortgage for registration. By this time, the lender had become aware of the fraud and had notified the Registrar and so the mortgage was not registered.

Arguing that it would have had indefeasible title had the mortgage been registered promptly, the lender sued the solicitor.

An important component of the argument was whether or not the terms of the loan agreement were incorporated into the mortgage. This was because if they were, then the amounts owing were secured by the mortgage (had it been registered), and the lender would have been able to exercise its power of sale to recoup its losses.

The Court of Appeal decided:

- Registration of a mortgage confers indefeasible title on a mortgagee.
- It is necessary to examine the terms and conditions of the mortgage to determine the scope of the estate or interest in land.
- Terms and conditions contained in an unregistered document can be incorporated by reference into a registered mortgage. However, whether they are will be a question of interpretation of the relevant mortgage instrument. All obligations mortgages, as currently drafted in New Zealand, are unlikely to incorporate the terms of separate loan agreements.
- A personal covenant to pay in a mortgage is independent of the charge created by the mortgage and does not attract indefeasibility on registration.
- If a mortgage is forged, or otherwise void, the personal covenant does not oblige the true registered proprietor personally, and the mortgagee is confined to its remedies against the land. However, if a personal covenant in a mortgage measures the amount of the debt secured by the land, then the amount is secured by registration, up to the value of the land.

While this case was primarily concerned with a situation of fraud, it is interesting that the Court of Appeal found that all obligations mortgages, as currently drafted in New Zealand, are unlikely to incorporate the terms of separate loan agreements. This was because the specific loan agreement was not specifically referred to, and so the terms of the loan agreement were not expressly incorporated into the mortgage.

¹ *Westpac Banking Corporation v Alan John Clark* [2008] NZCA 346

Legislation/In Parliament

Crown Guarantee Scheme - an overview

In response to similar initiatives abroad, the New Zealand Government announced a retail deposit guarantee scheme on 12 October. A further announcement of a wholesale funding guarantee facility followed on 1 November. The scheme has evolved over the past month but now appears to be mostly settled.

RETAIL SCHEME

The scheme was announced by Dr Michael Cullen in his previous role as Minister of Finance in order to ensure ongoing depositor confidence in New Zealand and to align the New Zealand market with the rest of the world. Failure to act is likely to have resulted in the migration of deposits from New Zealand banks to guaranteed banks offshore.

What is the scheme?

- The scheme guarantees deposits made by retail investors with certain types of financial institutions. Those institutions are:
 - registered banks (whether incorporated in New Zealand or overseas);
 - non-bank deposit takers; and
 - certain types of collective investments schemes (essentially unit trusts and managed funds).
- It is a guarantee of principal and interest and applies to all deposits except:
 - deposits made by financial institutions themselves; and
 - deposits made by parties related to the guaranteed institution.
- The guarantee covers a guaranteed financial institution that goes into default between 12 October 2008 and 12 October 2010.
- There are provisions enabling the Crown to revoke the guarantee if the relevant guaranteed institution fails to:
 - comply with prudential supervision requirements or their trust deed; or
 - provide information requested by the Crown or if any information provided is not accurate.

How are the eligible institutions defined?

- A registered bank includes any bank incorporated in New Zealand, and unincorporated branches of overseas banks. Some limits will apply to unincorporated branches of overseas banks – see below.
- A non-bank deposit taker is an entity that:
 - carries on the business of borrowing and lending, or provides financial services, or both;
 - issues debt securities; and
 - predominantly carries on its business in New Zealand.

- A collective investment scheme must invest exclusively in New Zealand government securities and in debt securities issued by institutions that are covered by the Crown guarantee. These schemes will have their deposits in the guaranteed institution specifically guaranteed rather than enjoying the benefit of the guarantee themselves.

Who will be guaranteed?

- It is expected that all institutions that are eligible for the scheme will apply to be covered by the guarantee. Those institutions are required to opt-in to the scheme and individual depositors will be able to check the Treasury's website to determine if the institutions with which they have deposits are part of the scheme.
- The Treasury has the ultimate discretion in deciding whether or not to extend the guarantee to an institution and may consider whether:
 - the business practices of the applicant meet reasonable standards;
 - the individuals that control the applicant are of good character and have appropriate business experience; and
 - the applicant has been in business long enough to justify its coverage by the guarantee.
- Further to the requirements above, a guaranteed non-bank deposit taker and a collective investment scheme subject to the guarantee will have to meet ongoing obligations that include:
 - limitations on transactions with related companies and issuing dividends;
 - requiring business to be conducted in a proper, businesslike, efficient and prudent manner;
 - allowing the Crown to appoint an inspector; and
 - imposing direct obligations on directors in relation to compliance with the company's trust deed and an increase in reporting requirements.

How much will be guaranteed?

- The scheme has been capped at a guarantee of \$1 million per depositor, per institution.
- There is no upper limit to which the overall scheme can be applied. This is qualified by a limitation on deposits held by branches of overseas banks. Those institutions are only guaranteed to the total amount that was on their books on the day the scheme was announced, with a small allowance for growth.
- Money held in a joint account will be split into equal shares to be attributed to each individual depositor.
- The scheme will look through a bare trustee and apply the cap to each individual beneficiary of a bare trust. A similar look-through will apply to collective investment schemes.

Will a fee be charged?

- Individuals will not be charged any direct fee in order to benefit from the scheme.
- For institutions that hold deposits over \$5 billion, a fee of 10 basis points per annum will be charged on those deposits that exceed \$5 billion.
- Institutions that hold deposits under \$5 billion will be charged a fee on the cumulative growth of their book value from the day the scheme was announced that is over and above the permitted growth of 10%. This fee will be charged on a graduated basis determined by the credit rating of the institution, as set out below:

<i>Credit Rating</i>	<i>Fee (bps per annum)</i>
AA- and above	10
A- to A+	20
BBB- to BBB+	50
BB and BB+	100
below BB and unrated	300

WHOLESALE SCHEME

The Government has also offered a wholesale funding guarantee facility to investment grade financial institutions that have substantial borrowing and lending operations in New Zealand.

Who will be guaranteed under the facility?

- The facility will be available to financial institutions that have a rating of BBB- or better. Eligible institutions are required to opt-in and will also be expected to have opted-in to the retail scheme where relevant.
- New Zealand branches of overseas banks are eligible, but only in respect of issues of New Zealand dollar instruments.
- The facility is not available to institutions that are financing a parent or related company, non-financial issuers (for example, corporate or local authority issuers) and collective investment schemes.
- Institutions that obtain the benefit of the guarantee will have to fulfil ongoing obligations, including:
 - additional capital buffers;
 - prudential supervision for registered banks;
 - non-bank institutions will be subject to additional information requirements; and
 - an undertaking that the foreign exchange risk associated with foreign currency borrowing will be hedged and managed.

What will be guaranteed?

- All new issues of senior unsecured negotiable or transferable debt securities in all major currencies are eligible. Covered bonds are also eligible. Other asset-backed securities and subordinated debt issues are not eligible.
- Participating institutions must apply for an eligible instrument to be covered. The facility operates on an opt-in basis for each eligible instrument rather than on the basis of automatic coverage for all eligible instruments of a participating institution.

What is the fee that will be charged?

- The fee will be charged on a 'per guaranteed instrument' basis. It is designed to ensure that the facility is used while it is needed, but will encourage issuers to graduate from using the guarantee as market conditions permit.
- The fee will be based on the credit rating of the issuer and the terms of the instrument guaranteed, as set out below:

<i>Credit Rating of issuer</i>	<i>Fee (bps per annum)</i>	
	<i>1 year term or less</i>	<i>1+ year term</i>
AA- and above	85	140
A- to A+	145	200
BBB- to BBB+	195	250

As mentioned above, the Treasury has the discretion to decide whether or not to grant the guarantee to an institution, whether retail or wholesale. The powers of the Treasury are designed to ensure regulators can eliminate any artificial applications. Provided that this discretion is exercised in a consistent and transparent way, especially with regard to the retail scheme, it can only benefit existing market participants by removing the potential for gaming of the scheme and the further distortion of the market that would follow.

The Treasury is in the process of approving registered banks and has begun approving non-bank deposit takers. Currently, 11 registered banks and 28 non-bank deposit takers have been approved. Approvals for collective investment schemes and wholesale guarantees are expected to follow.

Financial Advisers Act – territorial scope

Amendments are scheduled to the section dealing with the territorial scope of the recently enacted Financial Advisers Act. The version that is currently law today in New Zealand differs from the version that was passed by Parliament.

The recently enacted Financial Advisers Act 2008 (the Financial Advisers Act) sets out a framework for the regulation of “financial advisers” who provide “financial adviser services”. The version of the Financial Advisers Act that was assented to by the Governor-General includes the following section dealing with its territorial scope:

*“This Act applies to a financial adviser service performed in New Zealand **by a person in New Zealand**, regardless of where the person performing the financial adviser service is resident, is incorporated, or carries on business.” [emphasis added]*

This version is the law today in New Zealand. However, it differs from the version that was actually passed by Parliament. The Securities Commission was advised of this difference and intends to replace the section with:

“This Act applies to a financial adviser service performed in New Zealand ~~by a person in New Zealand~~, regardless of where the person performing the financial adviser service is resident, is incorporated, or carries on business.”

When it is amended, the Financial Advisers Act will apply to a financial adviser service that is provided to a person in New Zealand, regardless of the location of the financial adviser. Put another way, financial adviser services provided in New Zealand from offshore will be subject to the Financial Advisers Act. We expect this change to be made well before the regime comes fully into force in 2010.

When the Financial Advisers Act is amended, its territorial scope provision will be different to the territorial scope provision in the Financial Advisers Act’s companion legislation, the Financial Service Providers (Resolution and Dispute Resolution) Act 2008, which provides:

*“This Act applies to the provision in New Zealand of a financial service **by a person who is in New Zealand**, regardless of where the financial service provider is resident, is incorporated, or carries on business.” [emphasis added]*

Accordingly, issues may arise over the different application of each piece of legislation to offshore financial advisers.

In the journals

After the great debt capital markets crash of 07-11 **Bluestone Research, 21 September 2008¹**

A commentary on what led to the current state of debt capital markets, and what the future is expected to hold.

According to the article:

- The unprecedented dislocation of financial markets that has led to the failure of major institutions began with the creation between 2000 and 2007 of a "massive river of structured credit" by the world's investment banks. Within this flow of capital, over \$1 trillion of poor quality sub-prime business was originated and securitised.
- Securitisation, together with second and third order re-packaging, leveraged the risk and distributed it broadly through the financial system.
- The credit event became interwoven with a liquidity event from July 2007, as normal funding operations between financial counterparties broke down over concerns about counterparty risk. Preference for cash has drained liquidity from the banking system, which central banks are struggling to replenish.
- A glut of structured paper in the markets has forced secondary prices down to levels far below inherent value, and institutions with shorter term funding models are faced with increasingly difficult refinancing.
- Governments are struggling to get ahead of the wave of financial destruction, partly because they have been addressing distressed institutions as they flounder, rather than applying a structural repair strategy.
- In future, it is expected that debt capital markets products will be less complex, less leveraged, and more transparent, but that securitisation will continue to play a role.
- The article suggests that investment banks aren't dead, but it will be a long time before debt capital markets departments operate at the scale of the past few years.

¹ <http://www.bluestoneequityrelease.net.nz/page.aspx?id=484>

The Personal Property Securities Act 1999 and trusts – when is an interest under a trust a security?

Jonathan Orpin, *New Zealand Business Law Quarterly*, September 2008, Volume 14, Number 3

In this article, the author considers the conflict that arose when an insolvent debtor gave a security interest over all its property, which included property held on trust.

The author identified the following issues:

Is a beneficiary's interest in the trust property a security interest for the purposes of the Personal Property Securities Act (**PPSA**)?

If it is, and the interest is not perfected, the beneficiary's interest will be subordinated to the secured party (section 66(a) of the PPSA).

If the beneficiary's interest is not a security interest, then priority between the equitable interests of the beneficiary and the secured party is governed by common law.

New Zealand authority

The Court of Appeal has found that:

- A security interest is created where the debtor agrees to hold in trust for the secured party any proceeds of sale of inventory in which the secured party has an interest¹.
- Where an unregistered lease for a term of more than one year is given over assets in respect of which a general security interest is registered, the registered interest defeats the lessor's interest².

Such cases have not considered the statutory definition of "security interest" but instead have taken into account factors such as the role and relationship of the parties, practicality, commercial reality and intention.

Correct approach

The author considers that the correct approach is to interpret the definition of "security interest", as follows:

1. Identify the "interest in personal property".

The interest is the equitable interest held by a beneficiary. An equitable interest in personal property held on trust is an "interest in personal property", regardless of whether it is equitable or legal.

2. Determine whether the interest is "created or provided for by a transaction".

The author considers that this language is broad enough to cover:

- where a trust is "created" by a transaction as a security device; and
- where a transaction makes use of a trust already in existence to provide security (that is, it adds property to the trust fund).

The author makes the point that the interest in personal property under trusts must arise consensually (and not by operation of law).

3. Determine whether the interest in substance "secures payment or performance of an obligation".

¹ In *Simpson v New Zealand Associated Refrigerated Food Distributors Limited* [2007] 2 NZLR, 130

² In *Waller v New Zealand Bloodstock Limited* [2006] 3 NZLR, 629

The author considers that it is the interest itself, and not the transaction, that needs to secure payment or performance of an obligation. It is necessary to consider, if the obligation is not performed or the money is not repaid, will the beneficiary's equitable interest in the trust property secure the performance of the obligation or repayment?

Further, the author believes that the obligation must be separate from the trustee's obligations as trustee. For example, where a lender loans money to a borrower to buy new machinery, the borrower has a personal obligation to repay. To protect its interest, the lender requires the borrower to hold the machinery on trust until the loan is repaid. If the borrower defaults, the lender can enforce its interest in the machinery, in reliance on its interest under the trust. The lender's beneficial interest is more than just the embodiment of the borrower's obligation as trustee, it is a means of securing the obligation to repay.

Assignment of choses in action

Dr Roger Fenton, *The New Zealand Law Journal*, August 2008

In this article, Dr Roger Fenton assesses the effect of the Property Law Act 2007 on the assignment of choses in action.

The main focus of the article is the abolition by the Property Law Act 2007 (the **PLA**) of the requirement for notice of an assignment in order for an assignment to constitute a statutory assignment.

Notice not required for statutory assignment

Under section 50(1) of the PLA, an absolute assignment (that is, not a conditional assignment or an assignment by way of security) that is in writing and signed by the assignor constitutes a statutory assignment, and has the effect of passing legal title to the assignee. All of the rights and remedies of the assignor in relation to whatever is assigned, and the ability to give a good discharge to a debtor, are passed to the assignee.

Notice still important

One of the points made by Dr Fenton is that it is important to recognise that actual notice of assignment remains important because it is notice that imposes on a debtor the obligation to perform the obligation to the assignee and not the assignor. It also preserves priorities against competing third parties. In addition, notice is necessary to protect the assignee's position, since an assignee remains subject to equities, such as rights of set-off that exist prior to the assignment.

This change will impact on the way financings involving the assignment of debts (such as securitisations or factoring arrangements) are structured. Previously an equitable assignment was involved but a better result can now be achieved with a statutory assignment.

Bell Gully news

[Bell Gully partners lead Asia Pacific rankings](#)

The expertise of Bell Gully partners has been recognised with the leading overall rankings in this year's edition of international legal directory, *The Asia Pacific Legal 500*.

[Bell Gully's Damian Stone new co-president of Maori Law Society](#)

Bell Gully senior associate Damian Stone (Ngati Kahungunu) has been elected as co-president of Te Hunga Roia Maori o Aotearoa (the Maori Law Society).

[Bell Gully welcomes senior associates back from London](#)

Bell Gully has appointed three new senior associates in its Auckland office.

[Bell Gully stands out among New Zealand commercial law firms](#)

The firm has achieved top-tier rankings for each practice area featured in the just released 2009 edition of IFLR1000.

[Former Attorney-General to provide public law advice with Bell Gully](#)

Former Attorney-General Paul East QC, CNZM, has become a public law consultant with Bell Gully, forming a leading public law team with the firm's public law specialists partner Simon Watt and senior partner David McGregor.

[Working from home - as good as it sounds?](#)

Work-life balance and the flexible workplace is among the hot employment topics of the moment. What it really means for employers and employees was the subject of a seminar held at Bell Gully Auckland in September.

Useful Web links

New Zealand government

- [Consumer Affairs](http://www.consumeraffairs.govt.nz) [www.consumeraffairs.govt.nz]
- [Inland Revenue Department](http://www.ird.govt.nz) [www.ird.govt.nz]
- [Ministry of Economic Development](http://www.med.govt.nz) [www.med.govt.nz]
- [Ministry of Foreign Affairs and Trade](http://www.mfat.govt.nz) [www.mfat.govt.nz]
- [New Zealand Government](http://www.govt.nz) [www.govt.nz]
- [NZ Government E-Commerce Information](http://www.ecommerce.govt.nz) [www.ecommerce.govt.nz]
- [NZ Treasury](http://www.treasury.govt.nz) [www.treasury.govt.nz]
- [Office of the Clerk of the House of Representatives](http://www.clerk.parliament.govt.nz) [www.clerk.parliament.govt.nz]
- [Parliamentary Counsel Office](http://www.pco.parliament.govt.nz) [www.pco.parliament.govt.nz]

New Zealand financial agencies and organisations

- [Commerce Commission](http://www.comcom.govt.nz) [www.comcom.govt.nz]
- [The Companies Office](http://www.companies.govt.nz) [www.companies.govt.nz]
- [Export Credit Office](http://www.nzeco.govt.nz) [www.nzeco.govt.nz]
- [NZ Law Commission](http://www.lawcom.govt.nz) [www.lawcom.govt.nz]
- [Office of the Banking Ombudsman](http://www.bankombudsman.org.nz) [www.bankombudsman.org.nz]
- [Office of Insurance and Savings Ombudsman](http://www.iombudsman.org.nz) [www.iombudsman.org.nz]
- [Office of the Privacy Commissioner](http://www.privacy.org.nz) [www.privacy.org.nz]
- [Personal Property Securities Register](http://www.ppsr.govt.nz) [www.ppsr.govt.nz]
- [Reserve Bank of New Zealand](http://www.rbnz.govt.nz) [www.rbnz.govt.nz]
- [Securities Commission](http://www.seccom.govt.nz) [www.seccom.govt.nz]
- [Takeovers Panel](http://www.takeovers.govt.nz) [www.takeovers.govt.nz]

New Zealand commercial sites

- [CLANZ](http://www.clanz.org) [www.clanz.org]
- [Financial Services Federation](http://www.fsf.org.nz) [www.fsf.org.nz]
- [Institute of Chartered Accountants](http://www.nzica.co.nz) [www.nzica.co.nz]
- [NZ Bankers' Association](http://www.nzba.org.nz) [www.nzba.org.nz]
- [NZ Business Roundtable](http://www.nzbr.org.nz) [www.nzbr.org.nz]
- [NZ Institute of Economic Research](http://www.nzier.org.nz) [www.nzier.org.nz]
- [NZ Exchange](http://www.nzx.com) [www.nzx.com]

Australian government sites

- [Banking Ombudsman](http://www.abio.org.au) [www.abio.org.au]
- [National Office for the Information Economy](http://www.noie.gov.au) [www.noie.gov.au]

Australian commercial sites

- [Australian Financial Markets Association](http://www.afma.com.au) [www.afma.com.au]
- [Australian Securities and Investment Commission](http://www.asic.gov.au) [www.asic.gov.au]
- [Australian Stock Exchange](http://www.asx.com.au) [www.asx.com.au]

International sites

- [Bank for International Settlements](http://www.bis.org) [www.bis.org]
- [Global Banking Law Database](http://www.gbld.org) [www.gbld.org]
- [International Monetary Fund](http://www.imf.org) [www.imf.org]
- [International Swaps and Derivatives Association](http://www.isda.org) [www.isda.org]
- [NASDAQ](http://www.nasdaq.com) [www.nasdaq.com]
- [New York Stock Exchange](http://www.nyse.com) [www.nyse.com]
- [United States Securities and Exchange Commission](http://www.sec.gov) [www.sec.gov]
- [World Bank](http://www.worldbank.org) [www.worldbank.org]