RBNZA and CIMA: Acronyms for Disaster? Crisis management in the New Zealand financial system

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INTRODUCTION

At 8:30 pm on Thursday 13 September 2007, the news was leaked that the Bank of England had supplied emergency financial support to Northern Rock.[1] The bank run that followed was the first run on a UK bank since 1866, causing queues to form outside Northern Rock branches, phone lines to jam, the bank's website to collapse, and the withdrawal of £2 billion of deposits over three days. One million savers, 800,000 mortgage holders, 180,000 shareholders, and 6,000 staff were affected by the crisis,[2] and the rest of the world was reminded that bank failures are not a matter of 'if', but 'when'.

Unfortunately, Northern Rock was only the beginning of the turmoil that was to face the financial world. In March 2008, the Federal Reserve Bank of New York provided an emergency loan to ailing investment bank Bear Stearns, which was subsequently acquired by financial services firm JPMorgan Chase.[3] In July, concern arose around the stability of US mortgage financiers Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation), which jointly guarantee or own half of the US mortgage market. On Sunday 7 September, the US Treasury announced it would guarantee the firms' debts, at a cost of up to US$25 billion.[4]

Then, on "meltdown Monday" 15 September 2008, 158-year-old investment bank Lehman Brothers Holdings filed for bankruptcy, and the Bank of America purchased the struggling Merrill Lynch.[5] The next day the US Government announced it was injecting US$85 billion into the troubled American International Group Inc. (AIG), the world's biggest insurer, on the basis that disorderly failure would cause significant market

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[1] House of Commons Treasury Committee, "The Run on the Rock, Volume 1, Fifth Report of Session 2007-08", The Stationery Office Limited, London, 26 January 2008, p 5.
[2] BBC News, "Northern Rock in Facts and Figures", (18 February 2008), http://news.bbc.co.uk/1/hi/business/7250498.stm, accessed 27/03/2008.
[3] Stephen Foley, "Frantic Bail-out to Avert Us Banking Collapse", *New Zealand Herald* (19 March 2008), http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10498930, accessed 19/03/2008.
[4] BBC News, "Us Rescues Giant Mortgage Lenders", (7 September 2008), http://news.bbc.co.uk/2/hi/business/7502310.stm, accessed 17/09/2008.
[5] Bank of America will pay $29 per share, for shares that were worth $90 at the start of 2007 (BBC News, "Merrill Lynch Sold in $50bn Deal", (15 September 2008), http://news.bbc.co.uk/go/pr/fr/-/2/hi/business/7616068.stm, accessed 17/09/2008).

instability.[6] In the United Kingdom, Lloyds TSB bought out Halifax Bank of Scotland, and Bradford & Bingley followed Northern Rock into nationalisation.[7] Since then the turmoil has spread further into Europe, with the governments of Germany and Belgium stepping in to save ailing banks.

The New Zealand financial system has not been immune to this volatility. There has been considerable disruption, with 170,000 investors affected by the (currently) 41 finance companies which have frozen $5.7 billion of investors' funds.[8] While this does not necessarily signal that any of New Zealand's registered banks are in danger, it is clear "banks on occasion do get into trouble, and probably more often than is commonly thought."[9]

Part 1 of this dissertation looks at how the regulators could deal with problems in a New Zealand registered bank. "Ideally, a failing bank is closed on Friday afternoon after close of business, is acquired by another bank over the weekend, and opens its doors early Monday morning under another name,"[10] but this is not necessarily the case. The Reserve Bank of New Zealand is in the unique position of being able to recommend statutory management of a registered bank, where an independent manager is appointed to run the bank. This intrusion is warranted by the vulnerability of banks and the consequences of their failure for the financial system.

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[6] BBC News, "Us Government Rescues Insurer AIG", (17 September 2008), http://news.bbc.co.uk/2/hi/business/7620127.stm, accessed 19/09/2008.

[7] BBC News, "Lloyds TSB Seals £12bn HBOS Deal", (17 September 2008), http://news.bbc.co.uk/go/pr/fr/-/2/hi/business/7622180.stm, accessed 19/09/2008; UK Telegraph, "Financial Crisis: Bradford & Bingley to Be Nationalised by Treasury", (28 September 2008), http://www.telegraph.co.uk/finance/financetopics/financialcrisis/3095471/Financial-crisis-Bradford-and-Bingley-to-be-nationalised-by-Treasury.html, accessed 29/09/08.

[8] Hickey, B., "Will Rules Stop Finance Companies Failing?", *New Zealand Herald* (7 September 2008), http://www.nzherald.co.nz/finance-companies-in-freefall/news/article.cfm?c_id=1501786&objectid=10530914, accessed 15/09/2008.

[9] Bollard, Dr. A., "Supervising Overseas-Owned Banks: New Zealand's Experience" (2004) 67(3) *Reserve Bank of New Zealand Bulletin* 30. Registered banks have had their share of problems, with the failure of the Development Finance Corporation in 1989, and the Government having to provide liquidity support to the Bank of New Zealand in 1990. Banks may fail for a number of reasons, including the inherent weaknesses of banks; political intervention (for example, both DFC and BNZ had been government owned); state insolvency; bubbles and depressions, especially in real property (a factor in the current 'credit crunch'); macroeconomic factors such interest rates and inflation; poor management; and fraud (Wood, P., *Principles of International Insolvency*, 2nd ed. (Thomson/Sweet & Maxwell, London, 2007), 734).

[10] Asser, T., *Legal Aspects of Regulatory Treatment of Banks in Distress* (International Monetary Fund, Washington DC, 2001), 142. This is what the United States' Federal Reserve tried to achieve with Lehman Brothers, unsuccessfully negotiating the sale of the distressed bank with the Bank of America and Britain's Barclays Bank.

Clearly, it is not only registered banks which can get into trouble, and the Legislature has provided similar powers in respect of non-bank institutions. Part 2 of this dissertation looks at the powers the Corporations (Investigation and Management) Act 1989 gives the Securities Commission to recommend statutory management of a corporation, to increase the likelihood of the business continuing. Companies also have the option of appointing their own independent manager, under the Companies Act 1993 voluntary administration regime.

Part 3 considers the impact of voluntary administration on the Securities Commission's role to intervene in corporate distress. The statutory management provisions of Corporations (Investigation and Management) Act 1989 were subject to considerable criticism when they were first enacted, with calls for their repeal. However, these provisions have an important part to play in corporate insolvency law, and voluntary administration will not have a significant effect on the Securities Commission's functions.

Recommendations have been made to extend the Reserve Bank's jurisdiction to appointment of statutory managers to non-bank deposit takers and insurers. Consequently, both the Securities Commission and the Reserve Bank could recommend statutory management, which could lead to uncertainty over who would act. Part 4 discusses these recommendations and whether they are necessary, given the constitution of New Zealand's financial system, and the suggested grounds for their implementation.

1. SAVING REGISTERED BANKS

1.1 Statutory management under the Reserve Bank of New Zealand Act 1989

New Zealand's financial sector was heavily regulated until the early 1980's. In mid-1984 New Zealand embarked on one of the fastest and most extensive campaigns of economic liberalisation by any developed country,[11] and the Reserve Bank changed its focus from control of the financial system to managing it with the aim of financial system stability.[12] The 1986 amendments to the Reserve Bank of New Zealand Act included a framework for managing large financial institutions in serious financial difficulty, enhancing the Reserve Bank's ability to maintain financial system stability.

Statutory management was available where registered banks, dealers in foreign exchange, and large financial institutions were in severe financial difficulty or were threatening the stability of the financial system,[13] in order to provide for the institution's restructuring or orderly exit.[14] However, the effects of the 1987 sharemarket crash on the financial system led to the Reserve Bank of New Zealand Bill 1989, which was considered soon after the first instance of statutory management under the 1964 Act. This motivated the legislature to ensure changes were made which would help maintain public confidence in the operation and soundness of the financial system.[15]

The Reserve Bank of New Zealand Act 1989 (RBNZA) restricted the supervisory and management regime to the twenty registered banks, which were seen as the basis of the

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[11] Howie, C., and Ramsay, C., *The Reforms - Riding the Rollercoaster* (Allied Press, Dunedin, 1998).

[12] Prebble, Hon. R., (17 July 1986) 472 NZPD 3,111. Financial stability is where the financial system is capable of efficiently and smoothly facilitating the intertemporal allocation of economic resources; where forward-looking financial risks are assessed and priced reasonably accurately and are being relatively well managed; and where it can comfortably absorb financial and real economic surprises and shocks, (Schinasi, G., *Safeguarding Financial Stability: Theory and Practice* (International Monetary Fund, Washington DC, 2006), 82, in Arner, D., *Financial Stability, Economic Growth, and the Role of Law* (Cambridge University Press, New York, 2007), 135).

[13] The Act applied to financial institutions designated as "specified institutions" by the Reserve Bank under the Act; (Reserve Bank of New Zealand Act 1964, ss38J and 38K). For example, the Development Finance Corporation (DFC), the only 'bank' which has been placed into statutory management under the RBNZA, was not actually a registered bank but a 'specified institution' which had been in the process of becoming a registered bank.

[14] Prebble, Hon. R., above n12.

[15] Finance and Expenditure Select Committee, *Report on the Reserve Bank of New Zealand Bill 1989* [1987-1989] XVII AJHR, para 5.4.1. DFC was placed into statutory management on 3 October 1989 by DFC New Zealand Limited (Statutory Management) Order 1989: SR 1989/280 under the Reserve Bank of New Zealand Act 1964.

New Zealand financial system.[16] The Act provided the legislative machinery necessary for effective banking supervision, retaining the statutory management provisions giving the Reserve Bank power to constrain imprudent banks.[17]

1.2 General Structure

Purpose of statutory management

Statutory management is a key weapon in the Reserve Bank's arsenal against financial system instability, eliminating the owners' rights to exercise control of the bank and its managers.[18] A statutory manager takes control of the registered bank in order to save the bank to sell it as a going concern, which assists in the maintenance of a sound and efficient banking system,[19] or they may facilitate the bank's orderly exit to avoid significant damage to the financial system. There is no requirement that statutory managers or the Reserve Bank act to protect depositors' funds. This objective was contemplated by the Finance and Expenditure Select Committee considering the 1989 Bill, but was dismissed, as such a duty would weaken managers' incentives to act prudently, relieve depositors' need to monitor institutions, and put the burden of bank failure on taxpayers.[20]

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[16]Ibid. para 4.6.

[17] Morrell, K., "Banking Supervision - an Overview" (1990) 53(3) *Reserve Bank of New Zealand Bulletin* 270. "The fundamental objective still pulls [the Bank] in two directions simultaneously (system stability, thru [sic] supervision of individual institutions)." (Internal memorandum; RBNZ Archives, Box A0171, Econometric Model Forecasts October 1980, 5 November 1980, in Singleton, J., *Innovation and Independence - the Reserve Bank of New Zealand 1973-2002* (Auckland University Press, Auckland, 2006), 222.

[18] Asser, above n10, p 105. Other measures include registration, regulation and supervision of banks, disclosure requirements, investigation of the affairs of a registered bank, and giving directions to a registered bank.

[19] Financial system "soundness" is achieved when it can remain fully functional in the face of severe economic shocks; when registered banks have a low probability of failure; when a bank failure does not cause multiple bank failures or significant, prolonged dysfunction; and depositors, investors, and the public remain confident in the financial system, (Mortlock, G., "New Zealand's Financial Sector Regulation" (2003) 66(4) *Reserve Bank of New Zealand Bulletin* 5, 24)

[20] J. Sutton, (12 December 1989) 504 NZPD 14,502. This is in contrast to the approach taken in the United Kingdom, where the objectives of the banking regulator, the Financial Services Authority, includes the 'protection of consumers' (section 2(2)(c) Financial Services and Markets Act 2000). The Reserve Bank's stance remains that deposit protection insurance poses a significant risk of moral hazard, and may actually increase the risk of bank failures by reducing incentives for depositors and banks (Reserve Bank of New Zealand, "Questions and Answers, as Provided to the Press on 8 July 2004", http://www.rbnz.govt.nz/finstab/banking/regulation/0154814.html, accessed 17/09/2008).

To whom can statutory management apply?

Section 117 RBNZA only provides for statutory management with respect to registered banks and associated persons.[21] A "registered bank" is a person whose name is entered in the Reserve Bank's public register.[22] There are currently 18 registered banks in New Zealand, constituting an increasing majority of the New Zealand financial system.[23] Therefore, the achievement of stability of registered banks contributes greatly to the stability of the financial system as a whole.

Statutory management automatically subjects the subsidiaries of the registered bank to statutory management as well.[24] This prevents movement of assets from one entity to another to the detriment of depositors, and gives the statutory manager greater certainty as to the bank's balance sheet.[25] This helps in making decisions such as whether the bank should be sold, or whether the Reserve Bank should provide liquidity support.[26]

Grounds for statutory management

A registered bank is placed into statutory management by Order in Council, on the advice of the Minister of Finance in accordance with a recommendation of the Reserve Bank.[27] The grounds for a recommendation are the same grounds under which the Reserve Bank can issue directions to a registered bank.[28] Directions do not have to be issued before a

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[21] A person is an associated person of a registered bank if they control the management of the registered bank; have a qualifying interest in 20% or more of the securities issued by the registered bank; that registered bank controls the management of that person; or that registered bank has a qualifying interest in 20% or more of the voting or nonvoting securities issued by that person (RBNZA, s2(2)).

[22] RBNZA, s2. S69 requires the Reserve Bank to keep a public register of all registered banks in New Zealand.

[23] Reserve Bank of New Zealand, "List of Registered Banks in New Zealand (and Their Date of Registration and Credit Ratings)", http://www.rbnz.govt.nz/nzbanks/0091622.html, last modified 07 October 2008. In 2005, bank accounts accounted for 74% of the financial system assets in New Zealand (Bollard, Dr. A., "Bank Regulation and Supervision in New Zealand: Recent and Ongoing Developments" (2005) 68(2) *Reserve Bank of New Zealand Bulletin* 42). Due to the continuing failures in the finance company sector, bank accounts are now likely to comprise significantly more.

[24] RBNZA, s117(2).

[25] Bollard, Dr. A., "Systemic Financial Crises – Resolving Large Bank Insolvencies" (2004) 67(4) *Reserve Bank of New Zealand Bulletin* 35.

[26] Chetwin, W., "The Reserve Bank's Local Incorporation Policy" (2006) 69(4) *Reserve Bank of New Zealand Bulletin* 12, p 16, n 14. For example, when the DFC was placed into statutory management after the Government decided it did not wish to provide liquidity support, this extended to its core banking services, trade and finance division, its equity investments, and its wholly owned subsidiary companies (Francis, D., and Davies, T., *DFC New Zealand Limited (under Statutory Management) - Report to Creditors*, Wellington, 1990, p 2).

[27] RBNZA, s117.

[28] RBNZA, s118, which refers to the grounds for directions set out under s113, and the possible directions outlined in s113A.

recommendation of statutory management is made; that statutory management is more intrusive than directions should not mean it is automatically postponed until the less invasive method has been utilized first.[29] The same circumstances could lead to either directions or statutory management, so the Reserve Bank must consider which action best fulfils the purposes for which its powers are to be exercised, namely a sound and efficient financial system.[30]

The grounds for statutory management include insolvency or likely insolvency of the registered bank; the suspension, or imminent suspension of payments or the inability to meet obligations as they fall due; where its circumstances or affairs are prejudicial to financial system soundness; where its business has not been or is not being conducted prudently, or where the bank has failed to follow directions.[31] Clearly, these grounds are wide. With such an invasive action it would be expected that the bases for intervention would be more narrowly defined, but these amorphous considerations, such as circumstances "prejudicial to the soundness of the financial system" provide the Reserve Bank considerable discretion in determining whether it has authority to act.[32] This discretion is mitigated by the fact the Reserve Bank can only make a recommendation to the Minister, rather than place the registered bank into statutory management itself.[33] Individual ministerial responsibility will therefore have some influence on the appointment of a statutory manger and, as they are exercising a statutory power of decision, the decision to appoint can be subject to judicial review.[34]

[29] Asser, above n10, p 66. For example, in a situation of fraud or recklessness, such as led to the collapse of the UK's Barings Bank in 1995, the appointment of a statutory manager, the Reserve Bank's option of last resort, may be the only appropriate action (White, B., "Banking Supervision Policy in New Zealand" (1991) 54(2) *Reserve Bank of New Zealand Bulletin* 11).

[30] Morrell, above n17. The Reserve Bank must also support Australian financial authorities in meeting their statutory responsibilities relating to prudential regulation and financial system stability in Australia; and, to the extent reasonably practicable, avoid action likely to have a detrimental effect on financial system stability in Australia (ss 68, 68A).

[31] RBNZA, s113. The Development Finance Corporation was placed under statutory management as it was technically insolvent, and continuation of trade was unsustainable without substantial funding (Francis, above n26).

[32] Asser, above n10.

[33] "[T]he Reserve Bank does not have a carte blanche arbitrary discretion; it must still act through the Minister, who will remain accountable to Parliament by Order in Council." (T. de Cleene (11 December 1986) 476 NZPD 6069).

[34] Section 4 Judicature Amendment Act 1972 allows the High Court to review the exercise, refusal to exercise, or proposed or purported exercise of a statutory power, including a statutory power of decision as defined in s3.

Conduct of the statutory management

Section 117 provides for the appointment of "one or more persons" as statutory manager(s), but there are no specific legislative requirements as to who this should be.[35] A statutory manager must have had experience in the management of financial institutions, and a good understanding of banking and insolvency law and practice. As most government officials do not have strong business training or background, they are unlikely to be appointed.[36] For example, the statutory managers of DFC included chartered accountants, and a former bank Chief Executive, and were appointed based on their expertise and experience in the handling of corporate liquidations and receiverships.[37]

There is also no time limit on statutory management; the Reserve Bank can recommend that statutory management cease.[38] This should generally occur when the objectives of the statutory management have been achieved, or there is no longer a reasonable expectation the bank will avoid insolvency.[39] The registered bank, subsidiary, or associated person subject to statutory management may request termination at any time, but termination will only occur on the Reserve Bank's recommendation to the Minister.[40] The Reserve Bank may also give written notice to the Minister terminating the appointment of a particular statutory manager if they are unable to perform the functions of the office, are bankrupt, or have failed to perform their duties satisfactorily.[41]

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[35] However, the Reserve Bank has identified a number of essential or highly desirable attributes of statutory managers in its internal Crisis Management Toolkit, to be used as a guide in the appointment of statutory managers.
[36] Deane, R., "The New Wave of Financial Controls: the Case of Prudential Supervision", in Galvin, B., *Prudential Supervision of the Banking System - Papers from a Seminar Held under the Auspices of the Institute of Policy Studies, Wellington, Tuesday 25 August 1992* (Institute of Policy Studies, Victoria University of Wellington, Wellington, 1993).
[37] Brash, D., "The DFC Failure – Lessons for Banking Supervision" (1991) 54(1) *Reserve Bank of New Zealand Bulletin* 58, and Caygill, Hon. D., (14 February 1990) 4 NZPD Q Supp 3.
Samford (Sandy) Maier Jr had held managerial positions in international commercial and investment banking with Citicorp/Citibank, and had served on the Board of the Bank of New Zealand, (Mighty River Power, "Directors," http://www.mightyriverpower.co.nz/AboutUs/CompanyStructure/Directors/, accessed 23/09/2008). Another statutory manager, John Waller, now of PricewaterhouseCoopers and a director of BNZ, has been appointed receiver to a number of finance companies in recent times, including National Finance, Nathans, Bridgecorp, and Lombard Finance.
[38] RBNZA, s144. This is achieved through Order in Council. The statutory management of DFC New Zealand Ltd in the 1990's lasted just over 9 years, from 3 October 1989 to 23 December 1998.
[39] Asser, above n10, p 100.
[40] RBNZA, s144. Once the recommendation is made the Minister advises the Governor General, who may terminate the statutory management by Order in Council. The statutory management will terminate automatically upon liquidation (s144(2)).
[41] RBNZA, s141(1). The statutory manager may also resign by notice in writing (s141(2)).

The financial costs to the regulator of taking control of a bank can be significant. These costs must be borne by the failing bank, otherwise the bank and its owners gain an unfair advantage over other banks.[42] Consequently, obligations incurred by the statutory manager in the course of their duties are considered to be incurred on the registered bank's behalf, and must be paid in priority to all its other debts.[43] However, payment of these obligations is secondary to the payment of the costs, charges and expenses properly incurred by the statutory manager or advisory committee member in the exercise of their powers.[44]

1.3 Powers of statutory manager

The statutory manager has all the powers of management of that registered bank, and all the powers, rights and authority necessary for the purposes of Part V of the Act.[45] These are intended primarily for the bank's 'management', rather than its liquidation,[46] but as well as powers to carry on the bank's business,[47] the statutory manager has the power to apply to liquidate the bank.[48]

Section 122 RBNZA creates a moratorium on claims against the registered bank, but the statutory manager has the power to waive this in respect of the whole or part of any claim of a creditor or class of creditors.[49] This is necessary for the business of the registered bank to continue, especially if it is to be sold as a going concern.

The statutory manager also has powers outside the normal framework of corporate governance, including the ability to prevent the transfer or removal from New Zealand of

[42] Asser, above n10, p 70.
[43] RBNZA, s145. The statutory manager is not personally liable for those obligations.
[44] RBNZA, s148. Any remuneration approved by the Reserve Bank for the manager or committee members is also to be paid in priority to any other obligations incurred. For an outline of the role of the advisory committee, see the discussion of the powers of the statutory manager.
[45] RBNZA, ss128, 129.
[46] *Batkin Holdings Ltd v DFC Ventures Ltd* (1994) 1 NZLR 629, 635.
[47] RBNZA, s130. The statutory manager has the power to pay creditors and compromise claims between the bank and any other person (s131), suspend the whole or part of a repayment of any deposit, debt, or discharge of any obligation, and cancel all obligations to provide funding to any person, regardless of the terms of any contract (s127). This will not amount to a breach or repudiation of any contract entered into by the bank before the commencement of the statutory management period (s127(2),(3)).
[48] RBNZA, s136. However, the statutory manager must have the prior approval of the Reserve Bank.
[49] RBNZA, s122(3).

any property or assets of the registered bank, and a corresponding power to trace property improperly disposed of.[50] This gives the statutory manager the ability to curb the activities of overseas parent-banks. Fifteen of the eighteen registered banks in New Zealand are foreign-owned,[51] and there is a tendency for these banks to move large parts of their functionality, including information technology systems, accounting functions, and senior and mid-level management, to the offshore parent bank.[52] These important functions of a New Zealand branch or subsidiary need to be maintained if a parent bank is unwilling or unable to support its New Zealand operations.

The statutory manager can, with the Reserve bank's approval, sell, or otherwise dispose of, the whole or part of the registered bank, including property or assets subject to securities in favour of any other person.[53] The statutory manager has a very wide discretion as to who to sell to, and on what conditions.[54] These "purchase and assumption" transactions, where another bank or corporation purchases the assets and assumes the liabilities of the failing bank, involve a third party's assumption of the failing bank's liabilities.[55] This would normally require the creditors' consent, but obtaining the consent of all of the bank's creditors would be delaying, and probably impossible, so the statutory manager can transfer liabilities without it.[56]

Where the failing bank, or part thereof, is unable to be rehabilitated or transferred as a going concern to another bank, then it should be liquidated.[57] The statutory manager can apply under Part XVI Companies Act 1993 to put the bank into liquidation.[58] In doing so, the bank moves from a procedure designed to protect the financial system, into

[50] RBNZA, ss126, 138.
[51] Reserve Bank of New Zealand, above n23.
[52] Bollard, above n25.
[53] RBNZA, ss 132, 134.
[54] RBNZA, s132(1).
[55] Asser, above n10, p 144. Incentives would probably have to be provided for this to occur, such as temporary exemptions from prudential requirements. Ideally, the entire business of the bank would be sold. This is unlikely so a 'clean bank' purchase and assumption transaction could take place instead, transferring the unencumbered assets and known liabilities and liquidating the rest.
[56] RBNZA, s133.
[57] Financial difficulties may only be affecting part of the registered bank. The sound parts of the bank are usually transferred to other banks or corporations. The DFC's swap contracts were transferred to Barclays Bank plc, and Barclays and New Zealand Equities Ltd acquired DFC's futures contracts.
[58] RBNZA, s136. This requires the approval of the Reserve bank. The Governor General, by Order in Council, on the recommendation of the Minister, can order the winding up of the registered bank.

general insolvency law which takes little account of the public interest in financial stability.[59]

Overall, the statutory manager gains considerable power over the bank, its operations, and consequently, its depositors. In the exercise of their powers, they must prioritise the need to maintain public confidence in the financial system's operation and soundness, and the need to avoid significant damage to the financial system. Subject to these considerations, the bank's difficulties must be resolved as quickly as possible, and the position and ranking of creditors preserved.[60] The statutory manager consults with the Reserve Bank as to the exercise of their powers, and must have regard to any advice it gives.[61] A committee may also be to advise the statutory manager on the conduct of the statutory management and the exercise of their powers.[62] The statutory manager may also apply to the High Court for directions concerning the exercise of their extensive powers.[63]

1.4 Moratorium

The appointment of a statutory manager creates a moratorium on proceedings against the registered bank.[64] This provides "breathing space"[65] for the statutory managers to assess the situation, evaluate options, and negotiate with affected parties without the bank's

[59] Wood, above n9, p 748. Bank insolvency law aims to "remove the virus of contagion from the healthy body" that is the financial system. The statutory managers did not consider liquidation to be a favourable option for DFC, as it would constrain their ability to manage assets in a normal banking-business manner. An extended period of management would be required to maximise the value obtained from assets, due to the bank's maturity transformation role. The maximum value from the bank's lending would only be realised once the loans were repaid, which would take years. Liquidation would be prolonged, as creditors would not be paid in full until a comprehensive audit of the bank has been completed, all claims on the bank verified, and the value of all the assets available for payment has been determined, (Asser, above n10). Liquidation would also lessen the realisable value of DFC's assets, as a bank in liquidation would be more anxious to sell its assets, lowering their market value (Francis, above n26, p 18).
[60] RBNZA, s121(1)(a)-(d).
[61] RBNZA, s121. Where the Reserve Bank provides the statutory manager written directions regarding the exercise of their powers, the statutory manager must comply with these, unless the Court directs otherwise (ss 120, 142).
[62] RBNZA, s119. The advisory committee is appointed by the Minister on the recommendation of the Reserve Bank. It is to report to the Minister of Justice, at intervals of no longer than 6 months, on the exercise of its functions under the Act. (Palmer, Sir G., (22 May 1989) 94 *New Zealand Gazette* 2156). An advisory committee was appointed to the DFC statutory management to advise the statutory managers. The advisory committee was chaired by Sir Spencer Russell, a previous Reserve Bank Governor, and comprised members from NZI Guardian Trust, the Bank of New Zealand, and a number of bankers from overseas, (Caygill, Hon. D., (22 February 1990) 4 NZPD Q Supp 150).
[63] RBNZA, s142.
[64] RBNZA, s122.
[65] *Batkin Holdings Ltd v DFC Ventures Ltd,* above n46, p 8.

affairs falling into disorder.[66] It prevents actions or proceedings against the registered bank, the enforcement of any judgment or order in respect of the registered bank, the exercise of powers pursuant to mortgages, charges, or securities over the bank's property, or the exercise of any right of set-off against the bank.[67]

There are two justifications for imposing a moratorium.[68] Firstly, at a systemic level, a moratorium can help stave off a bank run, limiting the risk of runs on other banks and erosion of the soundness of the banking system. The Northern Rock run saw large withdrawals over a short period, but a short-term moratorium would have stemmed the rapid outflow of funds. Secondly, at a commercial level, the moratorium provides a chance to improve the bank's condition, either for the creditors' benefit, or in order to find a suitable takeover partner, "without being hampered by precipitate or unnecessary claims."[69]

A problem with the moratorium is the hindrance to rehabilitation.[70] Rehabilitation can only occur if ordinary banking business continues, which would involve incurring new liabilities whose payment would be suspended by the moratorium. Therefore, obligations incurred after the statutory manager's appointment would need to be exempt from the moratorium, which could result in some customers having 'active' accounts while their original deposits were unable to be drawn on. A statutory manager would be likely to waive a moratorium, at least in respect of small depositors, unless it is expected to significantly further creditors' interests, as otherwise these depositors bear the risk of further deterioration in the bank's financial condition.

A second problem is that moratoriums indicate financial weakness. Banks "do not respond well to a drawn out resolution process under the protective umbrella of a moratorium, as the trust in the bank is often lost."[71] A moratorium therefore reduces the

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[66] White, above n29. The suspension of payments, ceasing to offer new lending, and the inability of counterparties to claim or exercise setoff against the funds assisted in raising DFC's liquidity levels (Francis, above n26, p 18).
[67] RBNZA, s42.
[68] Asser, above n10, p 94.
[69] *Batkin Holdings Ltd v DFC Ventures Ltd,* above n46, p 9.
[70] Asser, above n10, p 95.
[71] Ibid., p 142.

failing bank's chances of meeting its funding needs at a reasonable cost, as it will have to rely on wholesale funding to become viable again, for which the market will charge high rates of interest to reflect the perceived risk. DFC's statutory management led to a premium being charged by overseas lenders.[72]

Therefore, the use of the moratorium requires a careful balancing between protecting the bank and its assets from proceedings, helping to maintain funds for depositors, and allowing business to continue in order to rehabilitate the bank and salvage its reputation.

1.5 Rationale for statutory management under RBNZA 1989

The RBNZA statutory management regime is a comprehensive procedure which allows the government to intervene before a registered bank is beyond saving. While the bank's fate is being decided, statutory management provides a holding period designed to protect financial system stability, while at the same time avoiding insulating depositors from the consequences of their investment decisions, and passing the risk on to the taxpayer. Although the failure of a single bank is no more concerning to the authorities than the failure of a supermarket,[73] the banking sector is among the most regulated sectors in world economies.[74] This intervention is justified by the vulnerability of banks, and the large externalities associated with their failure.

Vulnerability

Public confidence is tied to the *perceived* financial condition of the bank, the quality of its assets, and its liquidity.[75] This does not need to be an accurate perception; a bad bank with the public's confidence can continue operating, but a good bank without the public's

[72] McLean, I., (3 October 1989) 502 NZPD 12,874.
[73] Ledingham, P., "The Review of Bank Supervision Arrangements in New Zealand: The Main Elements of the Debate", (1995) 58(3) *Reserve Bank of New Zealand Bulletin* 163, 167.
[74] Ingves, S., "The Need for a Strengthened Insolvency and Resolution Framework for Banks – a Central Banker's Perspective", (International Bar Association's 14th Annual Global Insolvency and Restructuring Conference, Stockholm, 19 May 2008), p 2.
[75] E. Corrigan, "Are Banks Special?", *Federal Reserve Bank of Minneapolis, Annual Report 1982.*

confidence risks failure.[76] Banks are particularly vulnerable to losses in confidence because of their maturity transfer role,[77] as they borrow short and lend long, issuing liabilities redeemable on demand, and holding longer term assets that are less liquid and of uncertain value. This does not usually create problems due to the law of large numbers, but banks will be susceptible to shocks that drain deposits, which could lead to illiquidity and even insolvency.[78]

This maturity transfer role makes it difficult for depositors to determine a bank's soundness, as banks can continue to pay creditors even when experiencing financial difficulties, due to ongoing cash flow from deposits.[79] Depositors also lack the information needed to fully assess the risks of depositing with a particular bank. Unrestricted access to a bank's confidential information would compromise its competitive position, but the asymmetry of information that results can lead to poorly informed depositors withdrawing their deposits.[80]

Whereas the failure of a retailer would normally benefit other retailers by increasing their market share, a problem in one bank can lead to problems in other banks.[81] This contagion can occur directly, for example through the payments system, where one bank's failure to settle could result in other banks being unable to meet their

[76] Hüpkes, E., "Insolvency – Why a Special Regime for Banks?", in *Current Developments in Monetary and Financial Law,* Volume 3 (International Monetary Fund, Washington DC, 2003), 4.
[77] Wood, above n9, p 729.
[78] Crockett, A., "Why Is Financial Stability a Goal of Public Policy?", (Fourth Quarter 1997) *Federal Reserve Bank of Kansas City Economic Review* 5, 10. A bank does not hold funds anywhere near sufficient to be able to withstand the withdrawal of a large percentage of its deposits at once, but the 'law of large numbers' suggests that although the bank may 'lose' money when a withdrawal is made, the deposits of hundreds of other customers will mean that money lost is regained.
"Liquidity" is the ability to meet obligations when they come due without the bank incurring unacceptable losses, by balancing short term assets and short term liabilities. "Insolvency" is where total financial liabilities exceed total financial assets. Therefore, a solvent bank may experience liquidity problems, and an insolvent bank may still be able to meet its obligations in the short term. However, a bank that cannot meet its liquidity needs is usually not only illiquid but also insolvent (Asser, above n10).
[79] Hüpkes, above n76. For example, the public was unaware of Northern Rock's financial difficulties until the Press announced that the Bank of England had provided liquidity support.
[80] Brash, D., "Banking Supervision - Defining the Public Sector Role", (1992) 55(4) *Reserve Bank of New Zealand Bulletin* 307.
[81] Ledingham, above n73.

obligations.[82] It can also occur indirectly, as a loss of confidence in one bank can lead to a perception all banks are in danger.[83]

A crisis of confidence can lead to a bank run, where a large number of a bank's customers withdraw their deposits because they fear the bank is, or is about to become, insolvent. A bank run generates its own momentum as it progresses, becoming a self-fulfilling prophecy. The likelihood of default increases as more people withdraw their deposits, giving others an incentive to withdraw as well. For example, rolling television images of lengthening queues outside Northern Rock branches encouraged other depositors to join them.

Externalities

The most obvious effect of bank failure is the cost to depositors. They do not rank as preferential creditors; they are unsecured creditors who bear the direct costs of bank failure, just as with any commercial failure.[84] However, retail bank depositors are a very different type of unsecured creditor. Small, unsophisticated, "mum and dad" depositors are not well placed to protect their interests when dealing with banks and they stand to lose a lot; unlike creditors of other institutions, bank customers are likely to have most, if not all, of their money in one bank. As the statutory manager can intervene before the point of insolvency, this can protect depositors' interests. Unfortunately, the lack of adequate crisis regulatory mechanisms in the United Kingdom meant sophisticated investors had time to remove their investments from Northern Rock, increasing the cost to the taxpayer.[85]

However, statutory management under the RBNZA is not primarily concerned with the impact of failure on the creditors and shareholders immediately affected; its focus goes

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[82] The Reserve Bank is able to be a lender of last resort to the payments system, providing liquidity if a crisis occurs (see s31). As the UK banking sector's lender of last resort, the Bank of England provided Northern Rock with emergency funds.

[83] Crockett, above n78, p 11. This can be seen in New Zealand's financial system, where the failure of a number of 'finance companies' has led to a flight away from these institutions.

[84] "Prudential Policy in a Deregulated Environment", (1987) 50(1) *Reserve Bank of New Zealand Bulletin* 9.

[85] Dr Paul Hamalainen of Loughborough University in House of Commons Treasury Committee, above n1, para 174.

beyond the initial failure, to the adverse consequences for the financial system.[86] These externalities include prolonged interruption to business transactions, suspension of lending activity, deterioration in investor and business confidence, and harm to our international reputation.[87] An efficient financial system is a "vital component of any modern economy… a prerequisite for economic growth and welfare",[88] and the statutory manager aims to minimise the impact of a failure on that system as a whole.

The effect of one bank's failure is exacerbated by the position and influence of the banking sector in the financial system. In New Zealand, banks dominate deposit taking and lending, and hold 76% of the country's total financial assets.[89] This indicates the magnitude of the impact any significant dysfunction in the banking sector would have on the financial system. Banks are also the primary source of liquidity for most institutions or markets,[90] which depend on the banking system for cash or credit.[91] If there are problems in the banking sector, there is often nowhere else to shift borrowing activities. For example, DFC was set up specifically to improve capital access for firms, filling a gap in the market by providing funding for businesses who could not borrow from elsewhere.[92] When it collapsed in 1989, many businesses were unable to secure alternative funding and followed DFC into bankruptcy.

Bank failure can also trigger systemic risk, which is the risk of breakdowns in the financial system becoming financial difficulties in the wider economy.[93] It is generally

[86] Crockett, above n78, p 11.
[87] Mortlock, above n19. As 90% of DFC's debt was held by overseas institutions (Brash, above n37), it was imperative for the reputation of New Zealand's financial system that the failure was properly managed, as the "crash of a bank formerly owned by the Government … will contribute further to New Zealand's reputation of being the Wild West of international financial markets." (McLean, above n72), Banks also have a role in implementing the Reserve Bank's monetary policy through reserve requirements that could be affected by the failure of a registered bank.
[88] Mortlock, above n19, p 5.
[89] B. Gaynor, "Blame the Mess on a Lack of Self - Discipline", *New Zealand Herald* (9 August 2008), http://www.nzherald.co.nz/section/3/story.cfm?c_id=3&objectid=10526003&pnum=0, accessed 09/08/2008. In comparison, Australia's banking sector accounts for 52% of the country's financial assets.
[90] Hüpkes, above n76.
[91] Corrigan, above n75.
[92] See Development Finance Corporation Act 1964, s6.
[93] Kaufman, G., and Scott, K., "What Is Systemic Risk, and Do Bank Regulators Retard or Contribute to It?", (2003) 7(3) *The Independent Review* 371. Note that this is not the only definition of "systemic risk". It can also refer to that risk that banks cannot avoid, such as natural disasters, infrastructure failures, and recessions.

not possible to define ex ante which bank will be "systemically important."[94] In order to take effective action against systemic risk, the causes and effects outside the banking system must be addressed, in order to restore confidence, preserve banking services, and protect other parts of the financial system.[95] General insolvency law does not address the systemic implications, as the Court decides whether liquidation is necessary on micro-grounds; the focus is on the particular institution, rather than on the macroeconomy.

Externalities can also extend beyond a country's financial system. Increased globalisation in banking suggests that the failure of a large bank or disruption to important financial markets would increase the risk of global instability.[96] As 83% of New Zealand's registered banks are foreign owned, New Zealand is particularly susceptible to international systemic risk. If the parent of a New Zealand bank was impacted by events in a foreign financial system, it is likely that their local operation would also be affected, which could impact upon the New Zealand banking sector.

Banks operate in a rather precarious environment. They are vulnerable to losses of confidence, and when things go wrong, or are perceived to be going wrong, the crisis "feeds on uncertainty",[97] and there is nothing the bank itself can do to stop it. The effects of the failure of a bank on its depositors can be tremendous, but the impact does not stop there. The consequences beyond the initial failure are vast, leading to deterioration in confidence, triggering other failures, and can even extend to other countries' banking sectors.

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[94] Lind, G., "The Role and Approach of Contingency Planning for a Financial Crisis", (Reserve Bank of New Zealand Workshop on Banking Crisis Management, Wellington, 3 March 2005). For example, when Prime Minister Jim Bolger was informed that the BNZ was insolvent, his initial reaction was to let it crash. However, the government "bailed out" the BNZ when it recognised that it had around 40% of New Zealand's commercial market on its books, and the "domino effect" of its failure would be severe (J Bolger, *A View from the Top*, Viking, Auckland, 1998). Note that this episode is not necessarily conclusive evidence of the government's reaction to bank failure as the BNZ was government owned; the current stance is that the government would not "bail out" a bank in future. Time may tell whether the government would succumb to political pressure to prevent a bank's collapse.

[95] Asser, above n10, p 167.

[96] Hoggarth, G., and Soussa, F., "Crisis management, lender of last resort and the changing nature of the banking industry" in Brealey, et al, *Financial Stability and Central Banks - a Global Perspective* (Routledge, London, 2001). The world economy has recently seen how a shock to one country's economy can easily be transferred to another country, for example, Australia's ANZ, which owns New Zealand's ANZ-National had a $US120 million exposure to America's Lehman Brothers.

[97] Lind, above n94.

1.6 Evaluation of Banking Provisions

Banks are increasingly compared to essential services such as energy, water, and rail, as their failure impacts upon peoples' ability to live their lives.[98] They "are not like other companies" and should not be treated as such.[99] The RBNZA statutory management regime recognises this and manages the individual bank for the purpose of preventing the negative externalities previously discussed. Whether or not intervention is warranted in an individual case will depend on whether this will improve the soundness and efficiency of the financial system.[100]

Statutory management meets the banking sector's need for speed in insolvency. The Reserve Bank must act swiftly and decisively as delay can increase the losses and the costs of rescue.[101] For example, after the initial emergency funding, Northern Rock needed further liquidity support while the United Kingdom authorities struggled to find a solution, which increased the cost to taxpayers.[102] The extrajudicial nature of statutory management helps to achieve swift intervention. A "bank is insolvent when the [Reserve Bank] says it's insolvent,"[103] whereas under general insolvency law there must be proof of failure to meet liabilities as they fall due. Once a bank is proven insolvent under this test it would be too late for effective intervention.[104] Instead, the statutory manager can be appointed *before* it financial difficulty turns into financial failure. The Reserve Bank is also well placed to make an opportune recommendation. It is rapidly aware of a bank's difficulties, through its supervision of registered banks, and its involvement in the payments system and foreign exchange market.[105]

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[98] Tripartite Authorities, *Banking Reform – Protecting Depositors: a Discussion Paper,* October 2007, Box 3.3, p 13, in House of Commons Treasury Committee, above n1, para 169.
[99] Ibid., para 168.
[100] Brash, above n80.
[101] Basel Committee on Banking Supervision, *Supervisory Guidance on Dealing with Weak Banks*, Bank for International Settlements, Basel, March 2002, para 78. In the case of Northern Rock, indecision led to significant delay; tentative discussions for the sale of Northern Rock began on 25 September 2007, and the decision to nationalise the Rock was finally made on 17 February 2008.
[102] House of Commons Treasury Committee, above n1. These authorities are the "tripartite authorities", and comprise the Bank of England, the Financial Services Authority, and Her Majesty's Treasury.
[103] Hüpkes, above n76, p 10.
[104] Ibid.
[105] The Reserve Bank has powers to request information from registered banks (RBNZA, Parts 5 and 5B), and auditors of a registered bank must disclose information to the Reserve Bank if, in their opinion, the registered bank is insolvent, likely to become insolvent, or is in serious financial difficulty (s96). The Bank's role in overseeing the payments

Bank insolvency law must also address the public interest, as well as the interests of creditors (depositors), owners, and employees, which are the focus under general insolvency law.[106] This additional consideration is evident in the concern of statutory management to maintain the public's confidence in the banking system, as banks are extremely vulnerable to losses in confidence. The regime's ability to achieve this would be enhanced by increased public awareness of the role of the statutory manager and the process of dealing with difficulties in registered banks. A successful statutory management will lead to an expeditious and orderly resolution of the bank's affairs, and the prompt payment of deposits. This would restore confidence in the banking system,[107] and limit the significant externalities that can easily arise from failure. The concatenation of financial system soundness and the stability of the banking sector means that this is "an appropriate use of the [statutory management] regime."[108]

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system means that it automatically becomes aware of a bank's failure to settle with another bank through the system. A "payments system" is defined in s2 as a system or arrangement for the clearing or settlement of payment obligations.

[106] Asser, above n10.

[107] Ibid.

[108] Securities Commission, *The Corporations (Investigation and Management) Act 1989 - A Discussion Paper*, Wellington 1991, p 12.

2. NON-BANKS IN CRISIS

Registered banks have an important role to play in our financial system, and their vulnerability and the impact of their failure support a targeted bank insolvency regime. However, the role of banks in the financial system is becoming less unique. Non-bank entities, such as non-bank deposit takers and insurers, have also had a significant part to play in the recent sub-prime mortgage crisis and associated 'credit crunch'. Parliament has recognised this, enacting two separate pieces of legislation providing for the appointment of an independent manager to non-banks. The statutory management provisions of the Corporations (Investigation and Management) Act 1989 will be discussed in Part 2A, and the voluntary administration regime of the Companies Act 1993 in Part 2B.

2A. STATUTORY MANAGEMENT OF CORPORATIONS

2A.1 Statutory management under the Corporations (Investigation and Management) Act 1989

The Corporations (Investigation and Management) Act 1989 (CIMA) repealed the Companies Special Investigations Act 1958, which had replaced a trilogy of legislation designed to protect investors in a group of 13 companies, following allegations of fraud.[109] These Acts appointed the Public Trustee as receiver and manager of the group, with wide powers of management and a duty to conserve the companies' assets, which was made easier by a moratorium on proceedings against the companies.[110]

Fourteen groups of companies were placed into statutory receivership under the 1958 Act.[111] However, the complexity of major corporations increased significantly in the

[109] The Companies (Special Investigations) Act 1934, the Companies (Temporary Receivership) Act 1934, and the Companies (Special Liquidations) Act 1934.
[110] Companies (Temporary Receivership) Act 1934, ss6, 5, and 9.
[111] Securities Commission, above n108. There have been two other statutes providing for statutory management of specific companies - the Cornish Companies Management Act 1974, placing 78 companies in the Cornish group into statutory management, and the Public Service Investment Society Management Act 1979 provided for the statutory

1980's, and the 1987 sharemarket crash showed how the collapse of these large entities could harm our small economy.[112] This was an incentive for the Government to address the inadequacies in the laws relating to the collapse of large intertwined groups of companies.[113] The Corporations (Investigation and Management) Bill 1989 widened and strengthened the powers of statutory management in the 1958 Act, based on Part V RBNZA.[114] The Bill was well received by both sides of the House, but received much criticism from the financial community due to the Executive element of control and the lack of creditor involvement.[115] The statutory managers also have very wide powers, cutting across a range of legal relationships and obligations without giving disaffected parties recourse to the Court.[116] However the Minister of Justice was not convinced – "...the commercial community has only itself to blame if it does not like the law" – stating that "[t]he Bill will promote the orderly development of our company law, not prevent it."[117]

2A.2 General Structure

Purpose of statutory management

CIMA has two broad purposes:

> The first is to enable action to be taken earlier in instances when a company is, or may be, operating fraudulently or recklessly. The second is to enable companies to be given a decent burial when ordinary remedies are inadequate.[118]

The dual roles of investor protection and insolvency provisioning are evident in the management, moratorium, and restructuring arrangements in Part III, which promote the

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management of PSIS. Both had provisions similar to those found in the 1989 Act (NZLC, *Insolvency Law Reform - Promoting Trust and Confidence, an Advisory Report to the Ministry of Economic Development*, (NZLC SP11, Wellington, 2001)).

[112] Andrew Webster, "Legislation Notes: Corporations (Investigation and Management) Act 1989", (1988-1991) 6 AULR 453.

[113] Palmer, Rt. Hon. G., (13 September 1988) 429 NZPD 6,493-94.

[114] NZLC, above n111, para 287.

[115] Brown, D., and Telfer, T., *Personal and Corporate Insolvency Legislation: Guide and Commentary to the 2006 Amendments* (Lexis Nexis, Wellington, 2007).

[116] *Wilson and Others v Aurora Group Ltd* (1989) 4 NZCLC 65275, 65354, and see also the submissions of the New Zealand Bankers' Association, Securities Commission, above n108, p 9.

[117] Palmer, Rt. Hon. G., (21 February 1989) 496 NZPD 9,155.

[118] Palmer, above n113.

preservation of creditors' and other stakeholders' interests, as well as the resolution of the corporation's difficulties.[119] Under CIMA, statutory management is directed toward winding down rather than preserving the corporation's business, but it should not be used as an insolvency regime unless the interests of creditors or members of the corporation or the public interest could not be protected under other regimes.[120]

To whom can statutory management apply?

The statutory management provisions of CIMA were not designed as a routine method of dealing with corporate failure.[121] Instead, the Act was intended to apply to large and complex commercial entities,[122] and in practice has been utilised where a group's affairs were "so inextricably intertwined that the ordinary procedure of placing each individual company in the group in a separate receivership or liquidation would be cumbersome, unrealistic, unfair and time-consuming."[123]

CIMA has very broad application, as it applies to "corporations", defined as a body of persons, incorporated or not, and whether or not incorporated or established in New Zealand.[124] It can be brought into effect in two broad circumstances. Firstly, where any corporation is, or may be operating fraudulently or recklessly;[125] and secondly, where the interests of the parties or the public interest cannot be adequately protected under the Companies Act 1993 or in any other lawful way. Statutory management must also be desirable for the purposes of preserving the interests of its members or creditors;

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[119] *Wilson and Others v Aurora Group Ltd,* above n116, p 65,354.

[120] CIMA, s39. See also s41(1) and the prioritisation of the statutory manager's considerations. Some, however see it principally as an insolvency measure, as all corporations placed in statutory management so far have gone on to liquidation, (Ross, MJ., "Political Expediency and Misguided Insolvency Reform - the New Zealand Experience with the Corporations (Investigation and Management) Act 1989", (1994) 2(25) *Insolv LJ*).

[121] Letter from the Securities Commission, dated 18 August 1989, inviting comments on the Corporations (Investigation and Management) Act 1989, (Securities Commission, above n108, Appendix 2).

[122] Webster, above n112.

[123] Palmer, Rt. Hon. G., above n113. Equiticorp, when it was placed into statutory management in January 1989, was the eighth-largest listed company in New Zealand, comprising 148 separate companies connected through shareholdings or inter-company debts (Securities Commission, *Invitation for Submissions on the Corporations (Investigation and Management) Act 1989,* Securities Commission, Wellington, 18 August 1989).

[124] CIMA, s2. This was "designed to provide maximum flexibility to deal with different types of ventures operated through distinct entities." (*Waller v Rea* HC Auckland 8 October 2003, Heath J, CIV2003-404-5627; [2003] BCL 1065, para 8). There the Court allowed statutory management in respect of a trust.

[125] CIMA, s4(a). A corporation operates fraudulently or recklessly if it contracts debts and the officers did not honestly believe on reasonable grounds that the corporation would be able to pay these debts as they fell due as well as all its other debts; or where business is carried on in a reckless manner, or with intent to defraud (s6).

beneficiaries under trusts administered by the corporation; or for any other reason in the public interest.[126]

Grounds for statutory management

A corporation is placed into statutory management by Order in Council, made on the advice of the Commerce Minister on the recommendation of the Securities Commission.[127] However the grounds for a recommendation are rather convoluted.

Where fraud or recklessness is involved, statutory management may only be applied where it is desirable in order to limit or prevent the risk of further deterioration of the corporation's financial affairs; the carrying out, or the effects of, any fraudulent act or activity; or to enable the corporation's affairs to be dealt with in a more orderly or expeditious way.[128] If the Act applies because alternative protection is inadequate, then the corporation may only be placed into statutory management if it is desirable in order to preserve the interests of members, creditors, beneficiaries, or the public interest; or enable the corporation's affairs to be dealt with in a more orderly or expeditious way.[129]

These considerations have been criticized for being highly subjective, potentially political, and incapable of judicial review.[130] There were calls for more clearly defined criteria, due to the uncertainty engendered in creditors unable to judge the circumstances in which statutory management may be invoked, leading to unwillingness to provide finance.[131] In response, the Securities Commission outlined the factors considered in its decisions to put the Equiticorp, Richmond Smart, and Chase groups of companies into statutory management in the 1980's, including complex interlinked companies, many

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[126] CIMA, s4(b). S38 also provides for the statutory management of "associated persons", under the same grounds that apply to the corporation (s40(a)). They are people who control the corporation, own a certain share of the corporation, are controlled by that corporation, or who the corporation owns a certain share of (s2(2)). An Order of statutory management also subjects every subsidiary of that corporation to statutory management unless it is declared otherwise (s38(2)).

[127] CIMA, s38. The Order in Council does not need to specify under which limb of CIMA the statutory management is imposed; see the Order placing Equiticorp into statutory management under the CIMA (Corporations (Investigation and Management) Order 1989, (SR 1989/72)), which did not state the grounds on which the Order was made.

[128] CIMA, s39(b).

[129] CIMA, s39(c).

[130] Submissions by the Bank of New Zealand, Securities Commission, above n108.

[131] Submissions by the New Zealand Bankers' Association, Ibid.

unsecured creditors, lack of security enabling appointment of a receiver to the group as a whole, and the effect on the market.[132]

Determining whether the criteria for a recommendation are satisfied is a matter for the Securities Commission's discretion which cannot be interfered with by the Court. "[P]ublic interest is a classic area of discretion where the Commission's expert judgment is called into play,"[133] and in *Hawkins v Davison*, the Court of Appeal recognised it would be "highly unlikely that Parliament would have contemplated lengthy litigation …before it could be authoritatively determined whether the criteria for an Order in Council had been satisfied."[134] However, in determining whether the conditions are fulfilled, the right tests must be used, the relevant interests considered, and the ordinary obligations of the exercise of a statutory discretion complied with.

Conduct of Statutory management

As with the RBNZA, there is no direction in CIMA as to who can be appointed statutory manager. However, it is likely to be someone who has had experience managing a similar type of corporation. There is also no time limit on statutory management. The corporation, creditors or shareholders cannot bring about the termination, so statutory management could continue indefinitely.[135] For example, one of the Equiticorp group of companies remains in statutory management after almost twenty years.[136] An Order in Council is required to terminate the statutory management, but the Minister has the power to terminate the appointment of an individual statutory manager, and appoint a

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[132] Securities Commission, "Press Release", (3 August 1989), from Securities Commission, *The Corporations (Investigation and Management) Act 1989- A Discussion Paper*, Wellington 1991.
[133] *Crawford v Securities Commission* (2003) 9 NZCLC 263065, 263084-085 per O'Regan J, from Taylor, L., "Voluntary Administration", *Companies and Securities Law in New Zealand*, Farrar, J., et al (eds), (Thomson/Brookers, Wellington, 2008).
[134] *Hawkins v Davison* (1991) 5 NZCLC 66910, 66914.
[135] Securities Commission, above n108, Appendix 5.
[136] New Zealand Companies Office, "Companies Register", Ministry of Economic Development, http://www.companies.govt.nz/cms/banner_template/CNAME, accessed 20/07/08. This is Equiticorp International Number Two Limited.

replacement.[137] This could occur due to inability to perform the functions of their office, bankruptcy, neglect of duty, or misconduct.[138]

Costs, charges, and expenses properly incurred by a statutory manager or an advisory committee member are paid out of the corporation's property in priority to all other claims.[139] In some situations, the costs of the statutory management of one company may need to be borne by other companies in the group.[140] It is for the statutory manager to decide whether pooling the group's assets to meet the costs is fair in all the circumstances, taking into account the benefit of the statutory management to those companies.[141]

A security holder is to be paid out of the proceeds of the secured asset in priority to all claims other than the costs of selling that asset.[142] General statutory management costs cannot be defrayed against secured assets in priority to security holders' interests.[143] Costs must also be paid out of the "property of the corporation", which presented a problem in *Re Ararimu Holdings* when the costs could not be recovered out of funds to which the companies' clients had proprietary claims.[144]

2A.3 Powers of the statutory manager

The statutory manager's powers are wider than receivers' or liquidators' powers.[145] Management vests in the statutory manager upon a declaration of statutory management,

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[137] CIMA, s62. The statutory management will terminate upon liquidation (s62(2)). An Order declaring that a corporation is no longer subject to statutory management means the subsidiaries of that corporation also cease to be subject to statutory management (s62(5)).
[138] CIMA, s57.
[139] CIMA, s65. This includes remuneration approved by the Minister.
[140] *McDonald and Another v Australian Guarantee Corporation (NZ) Ltd and Others* (1989) 4 NZCLC 65,365. Where an associated person is also subject to statutory management, the Court may order that any costs of statutory management of the corporation be paid out of the property of the associated person (s65(2)).
[141] Ibid., p 65,609.
[142] CIMA, s51.
[143] *McDonald and Another v Australian Guarantee Corporation (NZ) Ltd and Others,* above n 140. In that case there were insufficient free funds available to enable the statutory manager to adequately administer the group. However, the Court held that the priority of the charge holder under s51 was subject only to the statutory manager's cost of sale of that specific piece of property, not to other costs of management.
[144] *Re Ararimu Holdings Ltd* [1989] 3 NZLR 487.
[145] Brown, D., *Corporate Rescue - Report for the Ministry of Economic Development,* Ministry of Economic Development, Wellington, November 2000.

and the statutory manager may exercise all such powers, rights and authorities as may be necessary to carry on that business and to carry out the powers conferred by Part III.[146]

These powers are considerable. For example, the statutory manager may sell or dispose of the whole or part of the corporation's business undertaking, to any person and on any terms as they see fit, and they can sell property or assets notwithstanding security interests.[147] Where property, including money,[148] is held on trust for the corporation, or has been improperly disposed of, the Court may order the property or its value be transferred to the statutory manager.[149] The statutory manager may terminate any contract of service or agency and discharge the corporation from further performance, notwithstanding that by law the contract could not have been terminated until a future date.[150] They can also suspend the payment of money owing, and this does not constitute repudiation of the contract.[151] These powers give considerable scope for prejudice against contracting parties who have to perform their contractual obligations even though the managed corporation does not.

The statutory manager is a public officer, answerable to the Registrar of Companies, the responsible Minister, and the Court.[152] The Minister may appoint a committee to advise the statutory manager on the conduct of the management and the exercise of their powers, but as the statutory manager does not need to report to the advisory committee or follow its advice, the Minister has minimal control over the statutory management.[153] The Court, however, on application of the statutory manager, may give the statutory manager

[146] CIMA, ss45, 47, and 46(1). This includes all powers, rights and privileges of the corporation under any contract, and all the powers of the members in general meeting or the powers of the governing body of the corporation (s46(2)).
[147] CIMA, ss50, 51.
[148] *Macmillan Builders Ltd (in Liquidation) v Morningside Industries Ltd* [1986] 2 NZLR 12 (CA) in Taylor, above n133.
[149] CIMA, s54.
[150] CIMA, s49. The person subject to the terminated contract may apply to the Court for compensation in respect of the contract (s49(2)).
[151] CIMA, s44.
[152] *Ararimu Farms & Investments Ltd v Stotter* [1993] MCLR 1, 6, in Taylor, above n133.
[153] CIMA, s60.

directions or grant additional powers,[154] but is unable to grant powers contrary to the express provisions of the Act.[155]

The statutory manager's powers must be exercised in accordance with the general objects of the Act, outlined in section 5. They must also have regard to the preservation of members' and creditors' interests, the need to protect the beneficiaries of any trust administered by the corporation, and the public interest.[156] CIMA provides no guidance for the statutory manager in this, nor gives any indication as to what the "public interest" involves. It also does not discriminate between the interests of members, creditors, or the public, which is confusing and gives rise to a number of conflicts of interest.[157] This also fails to reflect the creditor-protection purpose of the regime, and undermines the principle that the shareholders should bear the residual risk arising from operations.[158]

2A.4 Moratorium

Moratorium provisions are vital to maximising the value of asset recoveries.[159] Upon the statutory manager's appointment, a wide moratorium prohibits most creditor enforcement measures.[160] If these actions were allowed to proceed, they would likely erode the corporation's financial position and inhibit the resolution of its difficulties, harming the statutory manager's ability to preserve the business.[161] The moratorium prevents the *exercise* of certain rights for the period of the statutory management; the *existence* of rights is not affected.

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[154] CIMA, ss58, 59. For example, in *Re Ararimu Holdings Ltd,* above n144 , the statutory manager sought directions from the Court in anticipation of a multitude of actions to recover sums that were allegedly held on trust.
[155] *McDonald v Australian Guarantee Corporation (NZ) Ltd (No 2)* (1989) 3 BCR 483; (1990) 5 NZCLC 66,191.
[156] CIMA, s41(1)(a). They must then have regard to the need to resolve the difficulties of the corporation and, as far as practicable, the need to preserve the corporation's business or undertaking (s41(1)(b) and (c)).
[157] Securities Commission*, Statutory Management - Report to the Minister of Justice on Part III of the Corporations (Investigation and Management) Act 1989*, Wellington, April 1992, p 36.
[158] Ibid. For example, conflicts arise due to the moratorium provisions, as discussed in section 2A.4 of this dissertation.
[159] Principle 10: "Commencement: Moratoriums and Suspension of Proceedings", World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems,* World Bank, Washington DC, April 2001.
[160] This moratorium freezes proceedings; executions; winding up petitions; repossessions; and rights of set off (s42(1)). Prior winding up, liquidation, or receivership of the company also ceases, (s61) and there is a prohibition on the removal of property or assets of the corporation from New Zealand (s43).
[161] *Wilson and Others v Aurora Group Ltd,* above n116, p 66,295.

However, creditors' rights may be jeopardised by the inability to recognise them in a timely way. Secured creditors' positions may be worsened relative to unsecured creditors if the statutory manager decides to continue the business, as the secured creditor is unable to liquidate and recover their investment. The secured creditor therefore bears the risk of continued operation, for the benefit of unsecured creditors who may have received nothing had the business been immediately liquidated.[162] The statutory manager may waive the moratorium with respect to any creditor or groups of creditors, but there is no requirement of fairness or recognition of creditor priorities in doing so.[163]

Creditors may bring proceedings to determine the existence of any right or liability, with leave from the statutory manager or the High Court.[164] Leave to bring these proceedings is also relatively difficult to obtain, as the Court has to balance the legislative objects of preventing further deterioration and protecting interests, with the right of every citizen to bring their case before the courts.[165] A number of factors have been identified against which applications will be considered, including the strength of the applicant's case; the potential for resolving the issue in the ordinary course of statutory management; whether the litigation is likely to impede the statutory manager and delay achievement of the Act's objectives; and the existence of special features that put the applicant in a different position from others who do not seek to bring proceedings.[166]

The existence of a right or liability does not oblige the statutory manager to honour it or enable the plaintiff to enforce it.[167] Therefore this determination does not have a significant effect upon the objectives of the moratorium, so the statutory manager still has the opportunity to manager the corporation's affairs without interference.

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[162] Submissions of the New Zealand Bankers' Association; Securities Commission, above n108, p 43.
[163] CIMA, s42(3); and Lewers, B., *The Corporations (Investigation and Management) Act 1989 – Past, Present, Any Future?,* LLM Research Paper, Victoria University of Wellington, 1991, p 34.
[164] CIMA, s42(2).
[165] *Re Equiticorp Finance Ltd (in Statutory Management); Morris v Equiticorp Finance Ltd (in Statutory Management)* (1990) 5 NZCLC 66,465.
[166] Ibid.
[167] *Wilson and Others v Aurora Group Ltd*, above n116.

2A.5 Conclusion

Statutory management of corporations is a highly invasive procedure that affects the rights creditors have bargained for. As all "associated persons" are also automatically subject to statutory management, a creditor or supplier could discover they have unwittingly contracted with a member of a group. This would stay their claim against an otherwise solvent company, while the money that was to be used to pay them is used instead to pay the pool of creditors of the entire group. Such consequences are indicative of the lengths Parliament is prepared to go to achieve the Act's objectives,[168] and perhaps explain why these provisions have not been utilised with respect to finance companies despite the turmoil of the last few years. As CIMA provides an "extraordinary means of dealing with extraordinary situations,"[169] these statutory management provisions would have particular value in situations of fraud, or where important non-bank entities, such as utilities or infrastructure corporations, are involved.

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[168] *Re Equiticorp Finance Ltd (in Statutory Management); Morris v Equiticorp Finance Ltd (in Statutory Management)*, above n165. As noted previously, these objectives are, in relation to a corporation that is, or may be, operating fraudulently or recklessly, limiting or preventing the risk of further deterioration of the corporation's financial affairs and the carrying out, or effects of, any fraudulent act or activity. In the case of other corporations to which the Act applies, the object is to preserve the interests of members or creditors or beneficiaries, or the public interest. Statutory management also aims to provide for the affairs of the corporation to be dealt with in a more orderly and expeditious way.

[169] Securities Commission letter dated 18 August 1989, inviting comments on the CIMA, in Securities Commission, above n108, Appendix 2.

2B. VOLUNTARY ADMINISTRATION OF COMPANIES

2B.1 Voluntary Administration under Part XVA Companies Act 1993

Voluntary administration is another procedure for dealing with difficulties facing non-banks. It came about from a major review of New Zealand insolvency legislation begun in May 1999, with the aim of a simple, predictable regime for financial failure that could be administered quickly, imposed minimum compliance and regulatory costs, and which did not excessively penalise business failure.[170] The New Zealand Law Commission looked at the approaches of other jurisdictions, especially Australia's voluntary administration regime which places an independent administrator in charge of the company. Voluntary administration allows suppliers, financiers and creditors to work together to help a company find a way out of a temporarily difficult situation,[171] and was subsequently introduced to New Zealand through the Companies Amendment Bill 2006.[172]

2B.2 General Structure

Purpose of voluntary administration

Voluntary administration is not limited to situations of insolvency; it also applies where a company may become insolvent in the future. The aim is for the business, property, and affairs of that company to be administered so as to maximise the chances of the company or its business continuing, but, if this is not possible, to achieve a better return for creditors and shareholders than would result from immediate liquidation.[173] This is generally achieved via a deed of company arrangement which is executed by the creditors and the company, and provides for payment towards the creditors' debts.[174]

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[170] Ministry of Economic Development, "Insolvency Law Review", http://www.med.govt.nz/templates/ContentTopicSummary____4386.aspx, accessed 16/08/2008.

[171] Wong, P., (24 October 2006) 634 NZPD 6,051, during the second reading of the Insolvency Law Reform Bill.

[172] Companies Amendment Bill 2006, s6. The voluntary administration provisions form Part 15A of the Companies Act 1993. Given that this is a relatively new regime which so closely follows the Australian provisions, much of the general discussion on voluntary administration in New Zealand necessarily comes from commentary on the application of the regime in Australia.

[173] Companies Act 1993, s239A.

[174] Companies Act 1993, ss239B, 239ACN. This includes what property will be available to pay creditors, the extent to which the company will be released from its debts, and the priority of creditors' claims

To whom can voluntary administration apply?

The voluntary administration provisions apply to companies and limited partnerships.[175] It does not automatically extend to related entities, but if two or more related companies are in administration, the Court may order administration in respect of each proceed together as if they were one company.[176] Such an arrangement would aid rehabilitation by avoiding duplication of administrative processes, such as separate creditors meetings with the same creditors.[177]

Grounds for voluntary administration

Despite its name, companies can enter into voluntary administration voluntarily or involuntarily. In Australia, most administrators are appointed voluntarily by the company's board, as this avoids the considerable delay and expense of Court appointment.[178] As proof of insolvency is not required, voluntary administration provides a way for directors to respond early to financial difficulty, helping them in the discharge of their directors' duties.[179]

An administrator can be appointed 'involuntarily' by the liquidator, interim liquidator, a creditor holding a charge over the whole or substantially the whole of the company's property, or the Court.[180] A liquidator or interim liquidator may appoint an administrator

[175] "Company" is defined in s2 Companies Act as a company registered under Part 2 of the Act, or a company reregistered in accordance with the Companies Reregistration Act 1993. See also Limited Partnerships Act 2008, s100.
[176] Companies Act 1993, ss 239AER(1), 239AEW. In determining whether it is just and equitable to do order the administration proceed as a pool administration, the Court must have regard to the considerations under section 239AET.
[177] Cabinet Paper, "Insolvency Law Reform Bill - Final Cabinet Paper on Proposed Amendment to the Draft Bill" (January 2006), para 32.
[178] Under s239I. See *Brookers' Company and Securities Law, Vol 1 Company Law* (Brookers, Wellington, 2003) (updated 10.07.08), para CA239I.01. Appointments must be in writing, and state the date of the appointment. The administration begins upon appointment of the administrator (s239D).
[179] Directors' duties include the duty to act in what they believe to be the best interests of the company (s131), and to avoid substantial risk of serious loss to the company's creditors (s135). The appointment of an administrator is a factor for the Court to take into account when deciding whether to make an order against a director to repay money or return property under s301 (s301(4)). However, appointments must not be for an improper purpose, namely one outside the stated objectives. For example in *Blacktown City Council V Macarthur Telecommunications Pty Ltd* (2003) 47 ACSR 391, an administrator was appointed in order to avert an inevitable liquidation of the company, (Taylor, above n133).
[180] Companies Act 1993, s239H(1)(a)-(e). An administrator must consent in writing to their appointment (s239G).

if they think the company is insolvent or likely to become insolvent.[181] For substantially-secured creditors to appoint an administrator, the charge must have become, and remain, enforceable,[182] but there is no requirement the secured creditor believes the company is insolvent, or is likely to become insolvent, as there is for appointment by other parties. This encourages these creditors to appoint an administrator, rather than a receiver under the Receiverships Act 1993.

Other creditors, the liquidator, or the Registrar may apply to the Court for the appointment of an administrator, on the basis that an appointment is just and equitable, or that the company is or is about to become insolvent and administration would result in a better return for creditors and shareholders.[183] This allows those who may lack the power to make an out-of-court appointment to seek administration of the company.[184]

Conduct of the voluntary administration

There are a number of qualifications on who may be an administrator, in an attempt to increase administrators' independence.[185] Only a natural person who is not disqualified or prohibited from acting as a liquidator may be appointed.[186] Those appointed as administrators must have appropriate financial skills, especially of a 'reconstructive' nature.[187]

An administration will generally not last beyond 25 working days from the administrator's appointment. The "watershed meeting" of creditors is to be convened

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[181] Companies Act 1993, s239J(1). This is most likely to be used where a liquidator appointed to carry out a solvent liquidation finds that the company is actually insolvent, or is likely to become insolvent, (*Brookers' Company and Securities Law, Vol 1 Company Law*, above n178, para CA239J.01).
[182] Companies Act 1993, s239K.
[183] Companies Act 1993, s239L.
[184] Taylor, above n133.
[185] J. Vague, "Voluntary Administration in New Zealand", McDonald Vague, http://www.mvp.co.nz/articles/voluntary_administration.htm, accessed 15/08/2008. However, there have been some concerns that these qualifications will severely limit those who are available for appointment, (Rich, K., (24 October 2006) 634 NZPD 6,052 at the second reading of the Insolvency Law Reform Bill).
[186] Companies Act 1993, s239F.
[187] Financial Services Federation (Inc.), *Options for Change*, (Submission to Ministry of Economic Development on Insolvency Practitioner Regulation, Wellington, February 2007).

within 20 days of the appointment, and is held within 5 working days of that.[188] At this meeting a decision is made to carry out one of three courses of action: the execution of a deed of company arrangement; the appointment of a liquidator; or the cessation of the administration.[189] The Court can terminate the administration, but it automatically terminates if the convening period for a watershed meeting of creditors expires without a meeting being convened; there is no resolution for executing a deed of company arrangement; the proposed deed is not executed within a certain time; or the Court appoints a liquidator.[190] When voluntary administration ceases, the moratorium lifts, directors' powers are reinstated, and the administrator's statutory powers and indemnities are removed.

In introducing voluntary administration, policymakers were keen to avoid a regime involving overly costly reporting requirements or court applications.[191] Although many of those costs have been avoided, the cost of administration will not be insignificant.[192] The administrator is not liable for the company's debts, but they are liable for debts incurred in the performance or exercise of any of their functions or powers in respect of services rendered, goods bought, or property hired, leased, or occupied.[193] However, the administrator is entitled to be indemnified out of the company's property for this personal liability, in priority to the company's secured and unsecured debts.[194]

2B.3 Powers of administrator

The administrator's appointment does not remove the directors from office, but they are prevented from exercising any of their powers without the administrator's prior written

[188] Companies Act 1993, ss239AV, 239AT. "Watershed meeting" means the creditors' meeting called by the administrator to decide the future of the company and, in particular, whether the company and the deed administrator should execute a deed of company arrangement (s239B).
[189] Companies Act 1993, s239ABA.
[190] Companies Act 1993, s239E(2).
[191] Brown, above n145, p 43.
[192] Vague, above n185.
[193] Companies Act 1993, ss239ADG, 239ADH. This does not apply where the liability has been incurred in bad faith or negligently (s239ADL).
[194] Companies Act 1993, ss239ADL, 239ADM. This means the property as it existed at the time that the debts were incurred and the right to remuneration accrued, (*Cinema Plus Ltd (Admin Apptd) v ANZ Banking Group Ltd* (2000) 157 FLR 204, 218 (NSWCA) in Taylor, above n133). This priority is subject to s312, which provides that the preferential claims set out in Schedule 7 must first be paid, including the fees and expenses of the liquidator.

approval. This will appeal to creditors, who may well have lost faith in the directors.[195] The administrator controls the company's business, property and affairs; may carry on the business; terminate or dispose of all or part of that business and property; and may perform any function and exercise any power the company or its officers could have performed or exercised but for the administration.[196] The administrator has all the powers to carry out their functions and duties as administrator, and can also investigate the company's business, property and affairs.[197]

The administrator's powers are to be exercised to achieve the business' survival, or at least a better result than could be achieved with liquidation.[198] As the company's agent, the administrator is subject to fiduciary duties of care and skill in using their comprehensive powers.[199]

2B.4 Moratorium

The lodestar of the voluntary administration regime is the moratorium period, giving the administrator a chance to assess the company's viability before deciding whether to advise rehabilitation or liquidation.[200] Rights against the company or its property are suspended until the outcome of the watershed meeting, so during this period secured creditors may not enforce charges over property, owners or lessors may not recover property, and proceedings may not be begun or continued against the company without the administrator's written consent or the Court's permission.[201] The administrator can also apply to the Court for orders limiting the powers of secured creditors in relation to

[195] Companies Act 1993, s239X; see also Vague, above n185.
[196] Companies Act 1993, s239U.
[197] Companies Act 1993, s239V. The administrator must investigate the company's affairs and consider possible courses of action and can report on unlawful conduct (s239AE). This should deter directors viewing administration as a "soft option", (Brown, above n145, p 46).
[198] The administrator's powers include the powers to carry on the business of the company *to the extent necessary for the administration of the company* (s239V(2)(b)). This limits the exercise of the statutory manager's general powers to that which is necessary to achieve the stated objects of administration.
[199] Companies Act 1993, s239W.
[200] Dalziel, Hon. L., (26 October 2006) 634 NZPD 6,172.
[201] Companies Act 1993, ss239ABC, 239ABD, and 239ABE.

acts done *before* the administration, so long as the administrator's proposals will protect the creditors' interests. [202]

The moratorium therefore prevents interference in the disposition of the property, ensuring the administrator's task is not frustrated by legal proceedings.[203] However, as these limits cut into the rights of secured creditors, a concession is made to those with a charge over the whole or substantially the whole of the company's property, enabling them to enforce their charge within ten working days of the start of the administration.[204] The effect on creditors is also moderated by the administrator's discretion to lift the moratorium in favour of some creditors and the Court's ability to allow proceedings, although the Australian experience suggests courts will be reluctant to do so due to the detrimental effect of proceedings on the administration.[205]

2B.5 Conclusion

Voluntary administration adds to the general toolbox for dealing with corporate insolvencies. Although it has a similar basis to statutory management, voluntary administration's success relies on the cooperation of creditors, rather than on the use of their funds and the long-term deferment of their rights. Even if the need to negotiate an agreement between creditors makes voluntary administration less efficient, the creditors, rather than outsiders, get to determine the fate of the company that they effectively own. As a result, voluntary administration is a far less political process; instead of waiting for the Commerce Minister to advise statutory management, the creditors of the beleaguered finance companies could have applied for the appointment of an administrator. Voluntary administration aims to provide for the achievement of the best outcome possible for those involved, and brings New Zealand's corporate insolvency law in line with other jurisdictions.

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[202] Companies Act 1993, s239ABO, relating to acts carried out under s239ABM, including entering into possession of the property, or into agreements to sell the property.
[203] *Rodgers v Radly* (2001) 19 ACLC 848, in Taylor, above n133.
[204] Companies Act 1993, s239ABL.
[205] *Brookers' Company and Securities Law, Vol 1 Company Law,* above n178, para CA239ABE.05.

3. A New Role for Statutory Management?

In 1992, statutory management was considered necessary as there were no other adequate provisions for corporate moratoria and timely restructuring in corporate insolvency law, especially when dealing with a group situation.[206] However, voluntary administration has extended the recognition of creditor, member, and beneficiary interests under the Companies Act 1993. In light of this, it is questionable whether statutory management, an Executive-initiated procedure, is still preferable to mainstream insolvency law. Statutory management has been criticised as being "superimposed on New Zealand's general insolvency laws and counter to them."[207] Perhaps it is time this wide-reaching, but little-known regime was removed from New Zealand insolvency law.

In deciding whether statutory management has simply become an alternative to normal insolvency procedures, it is necessary to consider how far voluntary administration can and should meet CIMA's objectives in relation to group structures and financial failure.[208] As the voluntary administration regime performs a similar role to that of statutory management, has similar benefits, and addresses some of the specific concerns surrounding statutory management, it appears it may make redundant the role of statutory management in corporate insolvency.

3.1 Benefits of Statutory Management

Quick responses

Time is of the essence when a corporation reaches financial crisis point, as delay may hasten its demise.[209] Statutory management allows a quick response by the regulator in order to protect the corporation's assets.[210] This avoids the delay associated with Court

[206] Securities Commission, above n157.
[207] Barker, P., "Review of Statutory Management - Lessons for Australia?", (1991) 2(4) *Journal of Banking and Finance Law and Practice* 290.
[208] Brown, above n145, p 54.
[209] Securities Commission, above n157.
[210] CIMA, s38.

involvement, and the need for creditors to hold sufficient security to subject the entire group to mainstream insolvency proceedings. The statutory manager can also make decisions and take action without having to obtain permission. Voluntary administration similarly circumvents the delay of court processes, by allowing extra-judicial appointment of an administrator. However, voluntary administration has the edge in that the company is better placed to recognise it is in financial difficulty, and can place itself into administration immediately, rather than waiting for the recommendation of the regulator.

Flexibility of action

The statutory manager has a number of options for dealing with the corporation's affairs, including making arrangements with creditors, carrying on the business, selling the whole or part of the business, or liquidating.[211] This flexibility is enhanced in that the statutory manger is not bound by certain legal arrangements the corporation may have entered into.[212] A voluntary administrator has similar powers in the conduct of the administration, but they are not given such a free reign to act in disregard of third parties' rights. They also lack the crown indemnity the statutory manager enjoys, which may inhibit their actions.[213]

However, statutory managers are subject to greater constraints in the exercise of their powers, as they must consider the public interest as well as the interests of members and creditors.[214] This is a difficult task, as they must balance the interests of the corporation's members and the public, along with the conflicts between the public interest and the desire of secured creditors to realise their security. There are also inevitable conflicts between the different types of creditors. Actions for the benefit of unsecured creditors are often detrimental to secured creditors; continuing with the business of the corporation may benefit unsecured creditors, at the risk of diminishing the secured creditors'

[211] CIMA, ss48, 47, 50, and 46.
[212] See CIMA, ss51, 49, and 44.
[213] See CIMA, s63.
[214] CIMA, s5.

security.[215] Although CIMA suggests equal weighting should be given to these interests, where statutory management is utilised in order to protect the public interest, the public interest is likely to override the rights of creditors. As administrators do not need to consider the public interest, and will not have the same concern for shareholders' interests, they are actually able to respond with greater flexibility than statutory managers.

Avoiding the costs of court involvement

Extra-judicial procedures avoid costs as well as delay. As the costs of statutory management are paid out of the corporation's assets, this is clearly for the creditors' benefit, and as the Crown indemnifies the costs of statutory management,[216] this is in the taxpayers' interest as well. It is also possible to avoid these costs under voluntary administration.

Avoiding set-off

The statutory management moratorium prohibits parties exercising any rights of set-off they may have against the corporation.[217] Generally, set-off operates so that the obligations of one corporation are offset against their counterclaim, so they are only liable for the net amount. Under statutory management they must pay the full amount owed and go into the general 'pool' of creditors to get a share of the assets' proceeds.[218] Disallowing set-off means more funds for the pool, and creditors with a right of set-off are not paid in priority to other creditors.

[215] Submissions of David Jones of Phillips Nicholson and J King of Russell McVeagh, Securities Commission, above n108.
[216] CIMA, ss65, 63.
[217] CIMA, s42(1)(h).
[218] For example, in *Mayfair Limited v Brandon Brookfield*, (1989) 1 NZ ConvC 190,165, the defendant claimed costs for fitting out a building against M's claim for rent. The Court held that the ban on set-off meant that the counterclaim could not be brought, despite the fact that the defendant would just become a creditor and may not be able to recover the costs of fit out.

Voluntary administration, on the other hand, requires set-off, and only admits the balance under the deed of company arrangement.[219] This allows creditors with mutual dealings with the company to recover at least part of what is owed to them. Arguably, allowing set-off does not give some creditors priority over other creditors, as the company only owes the net amount. Although the general pool of funds will be smaller, the amount owed is also smaller. Overall, set-off better reflects the individual creditors' bargains with the company, as otherwise their right to receive the money owed to them is undermined.

Application to group insolvencies

CIMA's statutory management provisions were aimed at situations where it was necessary to take control of a group of corporations.[220] This was desirable as it would be unlikely that a creditor would have the power to appoint a receiver to the entire group. Instead, winding up proceedings would have to be commenced against each company separately, which would be complicated, costly, and time consuming. Statutory management's automatic application to all subsidiaries is "highly convenient,"[221] and for the Equiticorp statutory managers this meant they were "able to obtain more details of the bank accounts operated by…various "offshore" companies."[222] Even the critics recognised there was a need for a procedure for group insolvency.[223]

Voluntary administration has the potential to apply to group insolvencies, as the Court may order that the administration of two or more related companies proceed together as if they were one company.[224] This process is more cumbersome than under statutory management, and does not reap the same benefits as related companies are not automatically subject to administration.

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[219] Companies Act 1993, s239AEG.
[220] Securities Commission, above n157, p 7.
[221] CIMA, s38(2); Brown, above n145, p 30.
[222] Securities Commission, above n157.
[223] Submission of Phillips Nicholson, Securities Commission, above n108, p 9. "[T]he Companies Act itself [as it was then] is insufficiently flexible to allow for adequate control to be exercised in a group situation in the face of competing claims by secured creditors."
[224] Companies Act 1993, s239AER. "Related company" is defined in s2(3).

Extraordinary procedure for rehabilitation

One of the main advantages of statutory management is it provides for extraordinary situations, where ordinary regimes do not adequately protect stakeholders' interests.[225] When CIMA was first enacted the three most high-profile statutory managements occurred - Chase Corporation, Richmond Smart, and Equiticorp - but in the ensuing period New Zealand's small size, and the rarity of companies similar to these, led to doubt as to whether a discrete procedure for exceptional circumstances was actually worthwhile.[226] However, these extraordinary situations which may never have been seriously considered previously, such as the failure of the New Zealand Exchange Ltd (NZX, New Zealand's stock exchange), have recently become much more conceivable.

Voluntary administration, on the other hand, was adopted as an insolvency regime for ordinary situations. It was to target larger businesses, but also had to be capable of use by small to medium sized businesses.[227] However, its focus on continuing the business, and getting the best return for creditors, may limit its utility in extraordinary situations. Preserving the corporation's business is just one of a number of considerations for the statutory manager, making statutory management more responsive to exceptional circumstances.[228]

Emergency measure for continuing supply of essential services

Statutory management also has considerable potential where essential service providers are faced with collapse; for example, it was considered with respect to Air New Zealand in 2001.[229] It would allow the authorities to step in and run the business, ensuring continued supply of that service. The voluntary administration regime was also designed to handle problems arising through the insolvency of State-Owned Enterprises or utilities such as electricity.[230] However, as such events are likely to involve a significant element

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[225] NZLC, above n111, para 312, and CIMA, s4.
[226] Brown, above n145.
[227] NZLC, above n111.
[228] Companies Act 1993, s239A(a), CIMA, s41(1)(c).
[229] Ministry of Economic Development, *Insolvency Law Review: Tier Two Consultation Points*, Wellington, May 2001.
[230] NZLC, above n111.

of public interest, the more appropriate response is statutory management, with its objective of protecting the public interest, rather than voluntary administration, which focuses on the interests of creditors and shareholders.

3.2 Costs of Statutory Management

Uncertainty arising from the use of discretion

Considerable uncertainty surrounds a corporation in statutory management, due to the use of discretion from commencement to termination. Section 38 CIMA, authorising a recommendation of statutory management, is couched in permissive rather than mandatory terms, allowing the Securities Commission to use its discretion. The decision to terminate statutory management is also discretionary, so the corporation, and those dealing with the corporation, such as customers or employees, will not know how long it will be subject to statutory management. The statutory manager also has considerable discretion in the conduct of the statutory management, with CIMA providing little guidance.[231]

As an 'outsider', such as a regulator, cannot appoint an administrator, stakeholders have greater certainty as to the likelihood of administration, and the time limit means they know the administration will quickly conclude.[232] However, as the voluntary administrator's powers are subject to fewer considerations, those affected will be less able to second-guess the administrator's actions. Nevertheless, there is more uncertainty under voluntary administration than statutory management, as the administrator's decisions have a more narrowly defined objective, and administration will only last for a short period of time.

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[231] Ibid., para 325.
[232] See Companies Act 1993, ss239AT, 239AV.

Uncertainty for creditors

Like any other contracting party, creditors should be able to trust that the bargains they make in good faith will be respected.[233] However, creditors' rights are particularly affected by the moratorium and the manager's powers, over which they have little or no control.[234] "A regularised system of credit should be supported by mechanisms that provide … predictable models for recovering debt,"[235] but predictability is lost as statutory management imposes new rules for debt recovery, and undermines the secured creditors' right to appoint a receiver.[236]

The moratorium especially, is a "dramatic and automatic" interference with creditors' rights.[237] The risk of loss from continued trading shifts to secured creditors who are unable to utilise their security,[238] and so they do not know whether they will be able to recover their investment. Uncertainty also surrounds the extent of the moratorium. For example, if the creditor's claim is pursuant to a statutory power, the Court is likely to find it is not prohibited by the moratorium.[239]

The statutory manager also has powers that explicitly alter creditors' rights. "The reasonable expectations of the parties as expressed in their contract should be fulfilled";[240] however, the statutory manager can effectively ignore the contracts.[241] They are not bound by rules of pari passu, there is no discrimination between the stakeholders' interests, and creditors' rights are merely a consideration. The chance to bring

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[233] NZLC, above n111, para 320.

[234] See CIMA, s64. The corporation and its directors and members are not entitled to be consulted about the exercise of powers under the Act. The Act does not require the statutory manager to report to the creditors, who have the most to lose.

[235] Principle 2: "Enforcement of Unsecured Rights", World Bank, above n159.

[236] Brown, above n145.

[237] *Wilson and Others v Aurora Group Ltd,* above n116, p 65,298.

[238] Telfer, T., "Risk and Insolvent Trading" in Grantham, R., and Rickett, C., eds, *Corporate Personality in the 20th Century*, Oxford, Hart Publishing, 1998, p 128, in Wiseman, M., and Bos, M., "Directors' liabilities to creditors: the statutory guarantee of solvency", at Insolvency 2003 – The Conference for Insolvency Professionals, (Lexis Nexis Professional Development; INSOL New Zealand, Auckland, 27 and 28 February 2003).

[239] In *CIR v McDonald* (1991) 5 NZCLC 66,859, s42 did not prevent the CIR registering a charge under the Land Tax Act 1976 to secure payment of land tax that became due after the corporation was put into statutory management. Similarly, in *Watson v Waitemata Electric Power Board* (1989) 4 NZCLC 65,344, the power board was permitted to exercise its statutory power to discontinue electricity supply due to non-payment by a corporation under statutory management.

[240] *DHL International Ltd v Richmond Ltd* [1993] 3 NZLR 10; (1993) 4 NZBLC 103,101.

[241] See CIMA, ss44, 49, and 51.

proceedings to determine whether a right or liability exists does not provide greater certainty, as the statutory manager is not obliged to honour that right or meet that liability,[242] and leave to bring such a proceeding is difficult to obtain.[243]

Voluntary administration requires secured creditors' support,[244] as the creditors can initiate, terminate, and determine the outcome of the administration.[245] This need for agreement could create problems, for example Equiticorp's directors recognised that they had "too many banks and creditors really to get agreement among them all."[246] However, there are other options available under voluntary administration if a consensus cannot be reached.[247]

The moratorium under voluntary administration has a different impact on creditors' rights to the statutory management moratorium. That substantial security-holders can enforce their charges within 10 working days gives them greater certainty during the administration, and the time limit shortens the period in which creditors are prevented from taking action against the company.[248] The voluntary administrator also has more limited powers when dealing with creditors, as they cannot overlook contracts or security interests. Therefore, the creditors of a company under administration have greater certainty as to whether the company is bound by its agreements.

Creditors should be able to rely on their pre-insolvency entitlements being honoured, and overall, voluntary administration gives them more certainty. However, it may be that when CIMA is used instead, the public interest element may mean that the greater

[242] *Wilson and Others v Aurora Group Ltd*, above n116.
[243] See *Re Equiticorp Finance Ltd (in Statutory Management); Morris v Equiticorp Finance Ltd (in Statutory Management)*, above n165. The "starting point [is] that prima facie the issue of proceedings has been prohibited…" (per Wylie J., at p 66,477).
[244] Blanchard, P., Chair, (Intensive Business Insolvency, New Zealand Law Society – Continuing Legal Education, April 2007), p 2. Therefore the benefits of continued trading or deferred liquidation must exceed the benefits for creditors that are achievable through other means, such as receivership.
[245] See Companies Act 1993, ss239B, 239E, 239H, and 239ABA.
[246] Hawkins, A., and McLauchlan, G., *The Hawk* (Four Star Books, Mission Bay, 1989), 135.
[247] For example, if the creditors cannot approve a deed of company arrangement, the administrator will draft one for the creditors to inspect and comment on (ss 239ABB, 239ACP).
[248] Vague, above n185.

protection afforded by statutory management outweighs the economic and social cost of the uncertainty it creates.[249]

Extra-judicial procedure

The Court has little jurisdiction over the conduct of statutory management. Its role is minor or optional, such as granting leave, awarding compensation, or hearing applications.[250] This increases speed and flexibility, but it also means creditors do not have easy recourse to the Courts to make the statutory manager accountable; the only opportunity to challenge the statutory manager's decisions is judicial review ex post facto.[251] There is therefore no neutral forum for the resolution of issues between the parties.[252]

Voluntary administration strikes a better balance between speed and accountability. The parties most affected by administration, and those best placed to determine whether administration is necessary, are able to make an out-of-Court appointment. Other parties must apply to the Court. The Court also has a potentially greater role in the conduct of the administration, as creditors, shareholders, and liquidators can apply for orders which, in the statutory management context, the Minister would have determined.[253] As these decisions have the potential to be political, the Court's role in voluntary administration is an improvement on the statutory management regime.

Deterrence

Orderly and effective insolvency procedures foster growth and competitiveness, and give creditors greater confidence when extending credit or rescheduling claims.[254] Beyond the

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[249] NZLC, above n111, para 21.
[250] CIMA, ss42, 49, 58, and 59.
[251] Barker, above n207. As a result of this, the New Zealand Law Commission suggested that statutory management should be invoked by a Court order, and that reasons for the decision should be made available to all creditors on (NZLC, above n111, para 323).
[252] Reserve Bank of New Zealand, *Review of Financial Products and Providers - Prudential Regulation of Insurance, Consultation Paper*, Wellington, May 2008.
[253] Such as the termination of the statutory manager's appointment. The Companies Act 1993 allows the Court to remove the administrator on the application of the creditor, liquidator or Registrar (s239R).
[254] NZLC, above n111, para 10.

effect on the individual corporation, statutory management has potential to harm New Zealand's reputation, or make creditors less willing to supply credit, due to uncertainty over whether they will be able to enforce their security.[255] This is likely to lead to increased costs of borrowing for New Zealand corporations. The political nature of statutory management, such as in the decision to appoint a statutory manager, may also deter creditors. The ill-defined criteria are open to political abuse, for example where interest groups call for statutory management and the Executive obliges to court political favour.[256] The decision making process is confidential, interested parties are not entitled to be heard as of right, and the only basis for challenge is judicial review, making statutory management significantly different from overseas legislation of the same type.[257]

There is less uncertainty surrounding voluntary administration, so it is less of a deterrent to the provision of credit. Similar regimes exist overseas, so international creditors will be aware of their role under voluntary administration,[258] so the chance of a company being placed under voluntary administration will have a smaller impact on the cost of credit than statutory management allegedly had.

Implementation by Securities Commission

The "lack of business confidence in the State's performance of public enforcement duties designed to prevent irresponsible commercial behaviour,"[259] may be due to the lack of

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[255] ANZ bank claimed that some New Zealand companies were having to pay an increased margin for funds, and that others were having difficulty raising funds at all Securities Commission, above n108, p 9. See also the submissions of ASB Bank at p 8.
[256] Barker, above n207. For example depositors, and the action group Exposing Unacceptable Financial Activities, called for the Commerce Minister Lianne Dalziel to place certain finance companies into statutory management. See Exposing Unacceptable Financial Activities, "Press Release", (24 July 2008), http://www.scoop.co.nz/stories/PA0804/S00553.htm, accessed 28/09/2008, and the Commerce Minister's response, (Dalziel, Hon. L., "Speech to the EUFA Recovery Roadshow", (EUFA Recovery Roadshow, Wanganui, 23 April 2008), http://www.labour.org.nz/our_mps/lianne_dalziel/speeches/23042008_eufa_recovery_roadshow_lianne_dalziel.html, accessed 28/09/08).
[257] Securities Commission, above n108, p 9. In addition, the commencement by Executive rather than Judicial order may cause cross-border issues (NZLC, *Cross Border Insolvency - Should New Zealand Adopt the UNICITRAL Model Law on Cross-Border Insolvency?,* (NZLC R52, Wellington, 1999)).
[258] Particularly creditors from Australia and the United Kingdom, as their insolvency regimes, under the Corporations Act 2001(Australia), and the Insolvency Act 1986 (UK), are especially similar.
[259] NZLC, above n111, para 95.

information available to the Commission for it to carry out its duties under CIMA.[260] The Reserve Bank's continuous monitoring of registered banks under the RBNZA means that the Bank has the information required to make a determination regarding statutory management. However, CIMA states there is *no* obligation or duty on the Registrar or any other person to supervise or exercise any power in respect of corporations.[261] It is therefore unclear how the Securities Commission becomes aware of corporations in distress, suggesting corporations must be self-regulating to a certain extent.[262] For example, it was Equiticorp's directors who decided that "the size of the Equiticorp Group and the ramifications of its failure were so massive they should get the government involved to help control the damage."[263]

Companies must be self-regulating under voluntary administration, but the board can make a resolution of voluntary administration as soon as difficulties are identified. The directors are encouraged to do so, as this will be considered by the Court when making orders against directors. However, the need for self-regulation is a definite disadvantage in the statutory management context, as in the situations it targets the directors may be more likely to try to trade out of difficulty, in breach of their directors' duties, rather than to immediately report to the Securities Commission.[264] There needs to be a review and a reformulation of the process by which statutory management is implemented, so that less reliance is placed on self-regulation.

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[260] The Commission's functions under CIMA are recognised under section 10(1)(a) Securities Act 1978 as "functions and duties conferred or imposed on it by or under … any other enactment."

[261] CIMA, s7.

[262] In practice, the Registrar of Companies may request the Securities Commission takes action under CIMA (see the Securities Commission Annual Reports). The Ministry of Economic Development's role in ensuring compliance of insurance companies, superannuation funds, building societies, credit unions, finance companies, and managed funds to applicable laws, would provide some information on which to base requests, but overall, ongoing oversight, including review of financial reports, is very limited for the non-bank sector (International Monetary Fund, *New Zealand: Financial System Stability Assessment, Including Reports on the Observance of Standards and Codes on the Following Topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation,* International Monetary Fund, Washington DC, 2004, para 25).

[263] Hawkins, above n246, p 140. Equiticorp's directors subsequently rang the Reserve Bank and the Minister of Justice, (the relevant Act, the Companies Special Investigations Act 1958, was administered in the Ministry of Justice), and the group was put into statutory receivership.

[264] For example, on the evening before the Equiticorp group was placed into statutory management, the directors "knew that, if we could buy the time, we would win through. We had managed to balance our books every day until that point and we saw no reason to believe that we wouldn't be able to continue to do so, by being creative and by using the various available securities. We still had one or two tricks up our sleeve." Ibid., p 135.

3.3 The Role of Statutory Management under CIMA in light of Voluntary Administration

Statutory management removes control from the corporation and its creditors, and places the costs of rescue, ultimately for the creditors' benefit, on the State.[265] It gives rise to considerable uncertainty, has the potential for political influence, and raises the cost of credit. Nevertheless, CIMA has "served a useful purpose in enabling collapsed corporate empires to be administered a great deal more efficiently."[266] In 2001, the New Zealand Law Commission recommended statutory management be preserved, for use where the corporation's affairs cannot be adequately dealt with by any other insolvency regime; or where the public interest requires it.[267] However, there have been a number of proposals and changes to the corporate landscape and insolvency law since then such as the introduction of the voluntary administration, and CIMA is beginning to look expendable in light of these.

Voluntary administration has similar features to statutory management, but is more consistent with the insolvency regimes of our major trading partners.[268] It has a better process for implementation, including the ability to respond faster to difficulties, allows greater flexibility in dealing with the company's affairs, and strikes a better balance between Court involvement and the need for speed in insolvency. However, the key difference between the two, making CIMA indispensable, is the range of situations in which they can be applied.

Firstly, CIMA applies to 'corporations', whereas voluntary administration only applies to companies registered under the Companies Act, or limited partnerships. Statutory management is therefore capable of greater application, even extending to corporations

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[265] Brown, above n145, p 31. Costs of the statutory management are to be paid out of the property and assets of the corporation, but statutory management would often incur costs for the public because corporations in difficulty are unlikely to have sufficient assets to repay creditors.

[266] Walker, G., and Fisse, B., eds. *Securities Regulation in Australia and New Zealand*, Auckland, Oxford University Press, 1994, p 40.

[267] Ministry of Economic Development, above n229.

[268] Charles River Associates (Asia Pacific) Ltd., *"Insolvency Law Reform: Promoting Trust and Confidence" - Review of the Law Commission Report Submitted to Ministry of Economic Development,* Charles River Associates Ltd., Wellington, 2001, para 63.

that are not incorporated or established in New Zealand.[269] Secondly, voluntary administration relies upon the support of those creditors with charges over the whole or substantially the whole of the company's property.[270] Therefore it is only likely to apply where the benefits to those creditors of continuing trading or deferring liquidation exceed the benefits achievable by other means, such as receivership.

Thirdly, statutory management applies in situations of fraud or recklessness.[271] Company creditors are protected to some extent by the directors' duties. However, in the case of fraud or recklessness, statutory management removes those directors. This is valuable as it is unlikely these directors will voluntarily appoint an administrator.[272] Lastly, statutory management can be imposed where this would be in the public interest.[273] This provides for interests that may be indirectly affected by the corporation's collapse, for instance where the corporation is a State-Owned Enterprise, or strategic infrastructure business like water supply or an airline.[274] Voluntary administration does not contain a public interest provision, so although the administrator's appointment may protect the public interest, an appointment cannot be made for that specific purpose.

Statutory management therefore applies to a different range of situations. Despite their similar basis and comparable provisions, statutory management and voluntary administration are not substitutes. They have different roles – voluntary administration centring on run-of-the-mill insolvencies, and statutory management on extraordinary situations where the repercussions of failure are too significant for rehabilitation to be left to the creditors. The uncertainty for stakeholders, the harm to creditors' rights, and the lack of recourse to the Courts would be overshadowed by the public interest if NZX, for instance, was to succumb to fraud or financial difficulty. Even the potential for political abuse appears of little moment. Action groups have repeatedly petitioned the

[269] CIMA, s2.
[270] Blanchard, above n244, p 2.
[271] CIMA, s4.
[272] This is especially so in light of the administrator's duty to report misconduct by the directors (Companies Act 1993, s239AI).
[273] CIMA, s39(c).
[274] For example, statutory management was considered in respect of Air New Zealand when it was in financial difficulty in 2001 (Small, V., "Statutory Management - What It Means", *New Zealand Herald,* (24 September 2001), http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=218703, accessed 15/09/2008).

Government to use the statutory management provisions in respect of finance companies, but the Government has chosen to decline intervention, even though the relatively socially progressive Labour Government would seem to be more likely to intervene in the market to help protect creditors.

Statutory management applies in different circumstances to voluntary administration, specifically where the protections available under voluntary administration are insufficient. CIMA has a fluid application test, but it sets the threshold sufficiently high that statutory management is not just an alternative to voluntary administration and normal insolvency procedures. It is unlikely that voluntary administration would have reduced statutory management's role, as statutory management applies in such a select range of situations where the exceptional nature of the circumstances justifies such significant state intervention, and the problems associated with that.

3.4 CIMA and Registered Banks

Both CIMA and RBNZA provide for the statutory management of registered banks. From the discussion of the rationale behind statutory management of banks, it is clear that the failure of a bank would be a situation where CIMA's provisions would be applicable. The Securities Commission must consult with the Reserve bank before recommending statutory management under CIMA.[275] There has been criticism of this, on the basis that registered banks should only be subject to the RBNZA.[276] However, the two Acts have different objectives.[277] CIMA is primarily concerned with the impact of failure on those immediately affected, namely creditors and members. Although public interest is a ground for invoking CIMA, there is no requirement that the public interest is or will be affected. The RBNZA, on the other hand, caters for banks as a distinct entity with unusual characteristics, whose failure can have an impact far beyond the immediate crisis. Its focus is on the public interest rather than the individual bank's depositors. For example, but for the potential impact of DFC's failure on the foreign exchange market

[275] CIMA, s8(3).
[276] Barker, P., "Securities Commission's Report on the Corporations (Investigation and Management) Act 1989" (1992) 3(4) *Journal of Banking and Finance Law and Practice* 316, 319.
[277] Securities Commission, above n157, p 70.

and its overseas operations, statutory management could have been conducted under CIMA rather than the RBNZA.

As well as having different objectives, there are some situations where the RBNZA regime may not be desirable for policy reasons. As the grounds for statutory management under RBNZA include prejudice to financial system soundness, statutory management under the RBNZA could lead to negative inferences as to New Zealand's financial system stability.[278] As the grounds and objectives of statutory management under CIMA do not refer to financial system soundness, it may be more advantageous to use CIMA's "public interest" grounds to invoke statutory management of a registered bank.

Nevertheless, it is unlikely CIMA will be applied to registered banks. CIMA applies in two main situations, where there is fraud or recklessness, and where there are no adequate alternatives. The RBNZA allows intervention when business is not conducted in a prudent manner,[279] which is wider than CIMA. It is also unlikely that a situation would arise where the failure of a bank did not meet the threshold for statutory management under the RBNZA, or that RBNZA would not provide adequate protection as an alternative to the CIMA procedure. Therefore, CIMA has limited scope in relation to registered banks.

Making the RBNZA the sole basis for statutory management of registered banks could avoid a Northern Rock-type situation where, despite their Memorandum of Understanding, the Tripartite Authorities were unsure who was to take charge of the failing bank, delaying intervention and increasing costs.[280] As "the point when a micro-situation becomes a macro-problem is ill defined,"[281] the same uncertainty could arise here. The problem of identifying whether the problems will be confined to the

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[278] Ibid. There is a stigmatism attaching to financial institutions' use of special operations, as these may indicate that they are weak in some way (House of Commons Treasury Committee, above n1).
[279] RBNZA, s113(1)(e).
[280] Wearden, G., "Q&A: Darling's Daring Plan to Avoid Another Rock", *UK Guardian,* (4 January 2008),http://www.guardian.co.uk/business/2008/jan/04/northernrock/print, accessed 05/05/2008.
[281] Northedge, R., "The Loudest Bark", *Financial World Online,* (February 2008), https://www.financialworld.co.uk/Archive/2008/2008_02feb/Features/tripartite/13728.cfm, accessed 05/05/2008.

shareholders and creditors, or whether financial system stability could be affected, means it could be difficult to determine whether the Securities Commission should act under CIMA, or the Reserve Bank under RBNZA.[282]

In addition, the Reserve Bank, rather than the Securities Commission, is in possession of the information needed to make a timely, informed decision. Northern Rock showed that methods of information exchange between regulators are not always foolproof.[283] The Securities Commission's power to recommend statutory management of a registered bank is therefore redundant, as a situation where CIMA will apply to a registered bank is unlikely and, even if it occurred, the Securities Commission will not be aware of it in time to respond with the urgency required.

3.5 Evaluation of CIMA's Role

Statutory management under CIMA has been subject to considerable controversy, with many of the criticisms, such as uncertainty for creditors and lack of recourse to the Courts, being well founded. Although based on similar concepts, voluntary administration avoids some of the problems that have been identified with statutory management. However, it is not an alternative. Statutory management has a role in extraordinary situations which voluntary administration would not be able to fulfil. Although voluntary administration could have been utilised in relation to finance companies here in New Zealand, it would not suffice in the case of large corporate failures, as continue to occur in the United States.[284] Therefore, although its role in relation to smaller insolvencies may have been reduced, statutory management is not made redundant by voluntary administration.

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[282] Given the composition of New Zealand's banking sector, it is likely that a bank failure would have systemic effects (see the discussion on the rationale behind statutory management of banks). However, if the issue is one of fraud or recklessness, rather than system stability, this could be dealt with swiftly under CIMA, confining the problem to that particular bank.

[283] The UK banking regulator, the Financial Services Authority, possessed the information necessary to make the decision, but did not have the resources to provide emergency financial support. The Bank of England had the resources to provide funding to Northern Rock, but it did not have the institution-specific information necessary to allow it to make a timely decision as to Northern Rock's financial position. The Bank of England had the responsibility, without the information needed to discharge that responsibility (Buiter, W., "Responsibility without Information: The Bank of England as Lender of Last Resort", *Financial Times* (22 September 2007), http://blogs.ft.com/maverecon/2007/09/, accessed 05/05/2008).

[284] See the discussion in the introduction to this dissertation.

Statutory management under CIMA is redundant, however, in the case of registered banks. The threshold for application of CIMA means that it is unlikely to apply to registered banks, and the practicalities of implementation mean that it is unlikely to be used. Therefore, the statutory management regime under CIMA should no longer pertain to registered banks in New Zealand.

4. REFORM OF STATUTORY MANAGEMENT – THE REVIEW OF FINANCIAL PRODUCTS AND PROVIDERS

The Ministry of Economic Development's Review of Financial Products and Providers (RFPP), begun in 2005, considered the extension of the RBNZA statutory management provisions to non-bank deposit takers and the insurance sector. Recent Cabinet Papers recommended the adoption of these extensions.[285] There was no proposal for the removal of CIMA, creating a similar overlap to that which exists in respect of registered banks. These changes would increase the Reserve Bank's ability to intervene, not just in the banking sector, but in the financial system as a whole, and suggests a narrowing of the role of the Securities Commission under CIMA.

4.1 Non-Bank Deposit Takers

Non-bank deposit takers (NBDTs) offer debt securities to the public and carry on the business of borrowing and lending money or providing financial services.[286] Regulation of this sector harks back to the 1986 amendments to the Reserve Bank Act, allowing the Reserve Bank to recommend statutory management of dealers in foreign exchange and large financial institutions as well as registered banks, so the regime seems to have come full circle.[287]

Cabinet's recommendations include limiting CIMA to situations of distress or fraud, with the RBNZA provisions applying where the failure threatens financial system

[285] Cabinet Paper, "Review of Financial Products and Providers: Regulation of Non-Bank Deposit-Takers" (12 September 2007), and Cabinet Paper, "Review of Financial Products and Providers: Prudential Regulation of Insurance" (August 2008).

[286] RBNZA, s157C. This includes building societies, credit unions, the PSIS, and finance companies. Similar to the Reserve Bank of New Zealand Act 1964, there is a provision for the Governor-General, by Order in Council on the advice of the Minister on the recommendation of the Bank, to make regulations declaring a person or class of persons to be, or not to be, a deposit taker for the purposes of Part 5D of the Act (s157C(4)).

[287] The Reserve Bank of New Zealand Act 1964, s38K, provided for some financial institutions to be "specified institutions" under the Act. A "specified institution" was – (a) A registered bank; (b) An authorised dealer in foreign exchange; (c) A financial institution designated as a specified institution. The criteria for statutory management were similar to those in the current Reserve Bank Act (see Reserve Bank of New Zealand Act 1964, s38R).
The 1989 Act only applies to registered banks as it was inappropriate to put institutions under statutory management that were not subject to other prudential constraints (Finance and Expenditure Select Committee, above n15, p 8).

soundness.[288] The suggested grounds for statutory management are where a registered deposit taker (RDT) is insolvent or about to become insolvent, or has failed to comply with regulatory requirements; *and* the RDT's failure could impede the maintenance of a sound and efficient financial system or cause significant damage to the financial system.[289] A sound and efficient financial system is thus the overall objective of NBDT regulation, just as it is for registered banks.[290] NBDTs have important, bank-like functions, including receiving depositors' savings; providing credit, especially to sectors of the economy not readily serviced by banks; and are increasingly providing day-to-day transaction services. The rationale behind a specific statutory management regime for RDTs is therefore similar to that for banks, namely their vulnerability, and the negative externalities from their failure.

NBDTs are vulnerable to losses of confidence in the NBDT sector. They have the same maturity mismatch between assets and liabilities as banks, which can create liquidity risk and solvency pressure. Like banks, an NBDT's failure to meet its liabilities as they fall due is not necessarily proof of insolvency, and this, as well as the information asymmetry from incomprehensive, inaccessible, or untimely disclosure, and depositors' inability to interpret this, means depositors are unlikely to successfully distinguish between sound and unsound NBDTs. Therefore, risk aversion results in depositors treating all NBDTs as unsound, creating the domino-like contagion manifest in the finance company sector over the last two years.

NBDT failure also exhibits similar externalities. As well as creating losses for depositors, a large NBDT's failure could disrupt financial markets, payments systems, and liquidity, with the potential to create systemic instability, just like the failure of a bank.[291] International confidence in our financial system may be eroded, as the systemic risk could mean NBDT sector instability tarnishes the reputation of the system as a

[288] Cabinet Paper (NBDT), above n285, Recommendation 13.12.3.
[289] Ibid., Recommendation 13.12. A "Registered Deposit Taker" is a deposit taker that is licensed by the Reserve Bank.
[290] Ministry of Economic Development, *Review of Financial Products and Providers: Non Bank Deposit Takers, Discussion Document,* Wellington, September 2006.
[291] Ibid.

whole.[292] This could be particularly harmful to New Zealand, as our small country needs a stable financial system to attract international capital, in order to experience innovation and growth.[293]

Although NBDTs, like banks, are vulnerable to losses of confidence, the externalities from the failure of an NBDT are not as significant as the externalities from bank failure. NBDTs and the NBDT sector are small, and declining in importance in New Zealand.[294] These operations involve only a small proportion of the total assets of New Zealand's financial system. In 2003, finance companies' total assets amounted to $9.2 billion, whereas registered banks' total assets came to a more substantial $205 billion.[295] It is also doubtful that NBDT failure would erode international confidence in our financial system.[296] Foreign investors are likely to distinguish between NBDTs and registered banks, and as banks dominate our financial system, they would not equate instability in the NBDT sector with financial system instability.[297]

Although Cabinet recommends that the Reserve Bank be responsible for statutory management of RDTs, these suggestions only extend to where failure threatens financial system soundness. This is a much higher threshold than for statutory management under CIMA and, given the limited externalities of NBDT failure, one that is unlikely to be reached. Therefore the new RBNZA provisions would have minimal effect on the use of CIMA in respect of NBDTs, and would be unlikely to greatly increase the Reserve Bank's crisis management role.

4.2 Insurers

Cabinet also suggested a high threshold for the application of RBNZA statutory management to insurers. The grounds for this are where the insurer's failure could significantly damage the wider economy or financial system, or the insurer's

[292] Ibid.
[293] Dalziel, Hon. L., above n256.
[294] International Monetary Fund, above n262.
[295] Mortlock, above n19.
[296] Reserve Bank of New Zealand, *Non-Bank Deposit Takers: Summary of Submissions*, Wellington, 24 April 2007.
[297] Ministry of Economic Development, above n290.

circumstances involve fraud or recklessness; *and* statutory management is in the public interest, and policyholders and creditors cannot be adequately protected in any other lawful way.[298]

Once again, the rationale behind Cabinet's recommendation is similar to that for banks. Insurers experience a maturity mismatch between their assets and liabilities, and rely on the law of large numbers to keep the amount paid out to claims less than the amount received from premiums and investments. For instance, a natural disaster may lead to a large number of claims, which could trigger a default. Insurers are also vulnerable to information asymmetry. It is difficult for the policyholder to determine the insurer's stability due to its significant contingent liabilities, and the insurer relies on the policyholder to disclose all material information in order to appropriately underwrite the risk.[299] Insurers are also extremely vulnerable to fraud. The insurer will have determined the probability of an event occurring and allowed for that, but the policyholder's deliberate actions can make that event certain.

The externalities of large-scale distress in the insurance sector could also affect the wider economy.[300] Insurance contributes to economic development by reducing risk volatility, facilitating economic activity, reducing pressure on Government welfare, and enabling more efficient allocation of capital.[301] The failure of dominant insurers could significantly impede this development.

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[298] Cabinet Paper (Insurance), above n285.

[299] Before an insured event occurs, the insurer knows that they may be liable for up to a certain amount. When an insured event occurs, the liability has been "incurred, but not reported" (IBNR). Once the insurer is informed of the event, their liability has been "incurred, but not enough reported" (IBNER) to determine the extent of their liability until the claim is settled. This uncertainty makes it impossible to determine the extent of the insurer's actual liability.

[300] Ministry of Economic Development, *Review of Financial Products and Providers: Insurance, Discussion Document*, Wellington, September 2006. This is what led to the US Government's bail out of AIG. The systemic risk associated with its collapse was considerable, as one of the risks it insured was the risk that a mortgage provider would not recover the full amount of their lending. Many banks and investment funds would have lost insurance cover at a time when defaults were likely to rise (BBC News, above n6).

[301] Ministry of Economic Development, above n300, pp 14-16. Risk volatility is reduced as households and firms can transfer the risk of unforeseen events to parties who are more able to withstand the events. Economic activity is facilitated by removing some of the risk associated with entrepreneurship and innovation. Insurance can act as a substitute for Government welfare programmes. Capital is allocated more efficiently as instead of the insured saving up for a 'rainy day,' premium money is invested by the insurer, stimulating growth.

Cabinet's recommendations would reduce the Securities Commission's ability to recommend statutory management, but only to a limited extent. Both Acts could apply in situations of fraud or recklessness, but the RBNZA provisions create a higher threshold, as statutory management must be in the public interest, and the interests of policyholders and creditors must not be able to be adequately protected otherwise. It is possible that CIMA could provide that alternative protection. However, as CIMA's focus in situations of fraud is preventing deterioration of financial affairs and other effects of fraudulent activity, it is conceivable that CIMA may not provide adequate protection for policyholders and creditors, and so the Reserve Bank should respond. Nevertheless, it is very unlikely that CIMA, designed with creditor protection in mind, would not adequately protect creditor and policyholder interests in situations of fraud. Therefore it would only be in rare circumstances that the new RBNZA provisions could be applied.

The RBNZA would also apply where an insurer's failure could cause significant damage to the wider economy, provided the threshold discussed above is also met. However, it is unlikely that the failure of a New Zealand insurer would have that effect.[302] New Zealand insurance firms are not heavily involved in financial markets or payments systems, and there are few crucial inter-connections between insurers and the rest of the financial system. The unavailability of insurance cover would cause disruption, but this is unlikely to be economy-wide. Therefore, although the extension of the RBNZA statutory management provisions to insurers could reduce the scope of the CIMA provisions, the suggested thresholds for the RBNZA provisions are so high that this effect would be negligible.

4.3 Should Cabinet's recommendations be adopted?

The recommendations in the NBDT and Insurance Cabinet Papers do not add a lot to the present insolvency procedures. The thresholds for the application of the RBNZA

[302] AIG's interconnectedness meant that its failure exposed many other institutions. In New Zealand, however, there is less similarity between insurance companies and banks than between banks and NBDTs (Reserve Bank of New Zealand, *Annual Report 2008*). New Zealand has a much more vanilla financial system, shying away from some of the complex financial transactions that have caused significant trouble in recent times (see Bollard, Dr. A., "Reserve Bank confident in NZ financial system", (19 September 2008), from http://www.rbnz.govt.nz/news/2008/3424747.html, accessed 19/09/08).

provisions to RDTs and insurers are so high that in most cases statutory management under the RBNZA would not be available.

The suggested regime for NBDTs requires that failure of the RDT could impede the maintenance of a sound and efficient financial system, or cause significant damage to the financial system. In May 2008, the Reserve Bank maintained that although failure of a number of finance companies was causing 'upheaval' in the financial sector, there were unlikely to be widespread negative effects on the financial system or in the broader economy.[303] As this 'upheaval' has yet to lead to a recommendation of statutory management under CIMA, meeting the higher threshold under the RBNZA seems even more unlikely.

Cabinet suggested that the RBNZA provisions apply to insurers where failure could cause significant damage, or where fraud or recklessness is involved. However, as an insurer's failure is unlikely to cause significant damage to the wider economy, the most applicable ground is fraud or recklessness. However, there must also be no alternative adequate protection for policyholders and creditors, and there would be few situations in which CIMA's creditor-protection statutory management regime would be inadequate. Therefore, it is also unlikely that the threshold would be met for the application of the RBNZA provisions to insurers.

Extending the RBNZA provisions would only increase the potential uncertainty as to which of the Reserve Bank or the Securities Commission should act, which already arises in relation to banks. In situations where the effects of failure were sufficient for the Reserve Bank to act, any delay in determining which authority should act would exacerbate the situation and increase the damage to the financial system. There is also the potential for a Northern Rock-type split between information and responsibility. The Reserve Bank, as the prudential regulator of RDTs and insurers[304] and the supervisor of registered banks, may have the information to make a decision, but no power to

[303] Reserve Bank of New Zealand, *Financial Stability Report,* Wellington, May 2008.
[304] Cabinet Paper (NBDT), above n285, and Cabinet Paper (Insurance), above n285.

recommend statutory management unless and until the high thresholds were met. The Securities Commission would not have to wait for the same high threshold to be met under CIMA, but it lacks the information to make a decision. Although these authorities may work closely together, communication between the two may not always be adequate to allow timely intervention.

It is also unclear how much more information the Reserve Bank will have in order to make such a decision. The recommendations assume that the Reserve Bank will be aware that a RDT or an insurer is in difficulty, on the premise that the Reserve Bank is the regulator of NBDTs under the Reserve Bank of New Zealand Amendment Bill (No. 3), enacted in September 2008. However, the changes do not require the Reserve Bank to supervise RDTs; this remains the role of the trustees of the individual institutions.[305] Therefore the Reserve Bank's knowledge must come from its supervision of registered banks and the payments system, and will be unlikely to know significantly more about the circumstances of a failing finance company than the Securities Commission would in implementing CIMA.

The adoption of Cabinet's recommendations would mean insurers and RDTs would be under the jurisdiction of the Companies Act voluntary administration regime, and the CIMA and RBNZA statutory management regimes. Statutory management under CIMA provides an important alternative to voluntary administration in situations of fraud, or to protect the public interest. However, the extension of statutory management under the RBNZA is questionable. Firstly, NBDTs and insurers are not as vulnerable, and their failure would not create the same systemic risk. Therefore the rationale for a specific statutory management regime for banks does not exist in respect of NBDTs and insurers.[306] There are other non-bank institutions under the CIMA regime that may be

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[305] Reserve Bank of New Zealand, "Regulation of Non-Bank Deposit Takers Fact Sheet for the General Public", http://www.rbnz.govt.nz/finstab/nbdt/regulation/3389447.html, accessed 06/10/2008. Note that this refers only to non-bank deposit takers, and not insurers. The regulation of insurers is still at Cabinet stage, but this suggests that the Reserve Bank will have a role in supervising insurers (Cabinet Paper (Insurance), above n285).
[306] "Although there was significant agreement for the general reasons given for regulating NBDTs, many submitters argued that these reasons do not justify significant changes to the existing trustee-based arrangements. Many suggested that the existing regulatory arrangements are appropriate, given the rationale for regulating NBDTs..." (Reserve Bank of New Zealand, *Non-Bank Deposit Takers: Summary of Submissions*, Wellington, 24 April 2007, p2).

more deserving of a special regime, such as the New Zealand Exchange Ltd, or State-Owned Enterprises. Secondly, the suggested thresholds for the application of the regime are so high they are unlikely to be reached. Even if the thresholds were met, the negative inferences international investors could draw about New Zealand's financial system stability may mean the provisions would still not be used. This makes the extension of the RBNZA statutory management provisions unwarranted, and simply an exercise in investor placation, through giving the Reserve Bank the appearance of greater influence over the financial system. Thirdly, the application of RBNZA in addition to CIMA will cause the uncertainty as to which of the Reserve Bank or the Securities Commission will act when an insurer or an RDT is in distress, at the cost of an orderly and expeditious resolution. Finally, the Reserve Bank will be no more aware of the distress of a RDT than the Securities Commission would be under CIMA, so it is unclear what will be gained by putting them under the preserve of the Reserve Bank. Certainly extending statutory management under the RBNZA is an area where more consideration is required.

4.4 Conclusion

While the credit crisis continues, New Zealand's banks are increasingly exposed to the ultimate effects of increased funding costs. New Zealand's low savings rate and dependence on foreign funding make New Zealand's financial system particularly vulnerable, and recent global difficulties have indicated the need for New Zealand regulators to be able to intervene here at home.

It appears as if they are. Any participant in the New Zealand financial system can be placed into statutory management for a number of reasons, including fraud, insolvency, protection of stakeholder interests, or the maintenance of a sound and efficient financial system. New Zealand's insolvency law recognises the importance of banks to the financial sector, and the banking sector is subject to regulation and supervision by the Reserve Bank, which can also intervene and appoint an independent manager in situations of distress. The Legislature has been proactive in recognising the influence of non-bank entities as well, and has provided a comprehensive statutory management

regime in CIMA, based on the RBNZA procedure, to deal with situations of fraud or recklessness, or where the public interest requires intervention into corporations' private affairs.

Parliament also allows companies in distress to do-it-themselves, and appoint a voluntary administrator to manage the company. The voluntary administration procedure complements the statutory management provisions, leaving the Securities Commission to intervene in only the most extraordinary of situations. Any criticisms of the statutory management regime appear trivial in light of the exceptional circumstances these provisions are designed to address.

What does not work so well is where these two schemes, banking insolvency law and general insolvency law, overlap. Both CIMA and RBNZA statutory management provisions apply to registered banks, which is unnecessary at best, and at worst could damage the financial system in a crisis situation. The regulatory failure surrounding Northern Rock should be an example to the New Zealand authorities of the threat to the financial system when responsibilities are replicated.

Cabinet's recommendations to extend the RBNZA statutory management provisions to NBDTs and insurers would increase the overlap between the two. Law makers should think carefully about implementing these recommendations in their present form. Firstly, the structures of these sectors differ from that of the banking sector. Although they may exhibit similar qualities to varying degrees, NBDTs and insurers are not banks. The externalities of their failure are much lower, and unlikely to meet the thresholds stipulated in the RBNZA provisions designed to deal with failing banks.

Secondly, the laws surrounding these sectors differ from the banking sector. Both NBDTs and insurers are currently relatively unregulated, whereas the Reserve Bank has a considerable role in the banking sector. These suggestions take the crisis management provisions from banking law, with its comprehensive registration and supervision arrangements, and apply them to non-bank sectors with less-rigorous entry requirements,

and trustee-based supervision. The result is an unwieldy regime which is unlikely to be utilised, and which seems to have the aim of simply appeasing investors and policyholders. Although it may achieve this aim, the 'solution' it provides is ineffective.

Banking law has different objectives to insolvency law, and this has not been acknowledged in the Review of Financial Products and Providers. The application of banking law to non-banks does not make sense in light of the general corporate law that otherwise governs these sectors and their role in the financial system, and should be reconsidered before Parliament enacts the Reserve Bank of New Zealand Amendment Bill (No. 4).

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