

The Treasury

Project Korimako - Release of advice

December 2022

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- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [36] 9(2)(h) - to maintain legal professional privilege
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

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TE TAI OHANGA
THE TREASURY

Treasury Report: Kiwi Group Holdings: Engagement and work programme

Date:	10 March 2020	Report No:	T2020/593
		File Number:	SE-2-12-4 (Kiwibank)

Action sought

	Action sought	Deadline
Minister for State Owned Enterprises (Rt Hon Winston Peters)	None	None
Minister of Finance (Hon Grant Robertson)	Note the suggested talking points for prospective meetings Agree that the Treasury undertake the first phase of the work programme outlined	Thursday 19 March 2020
Associate Minister of Finance (Hon David Parker)	None	None
Associate Minister for State Owned Enterprises (Hon Shane Jones)	Note the suggested talking points for prospective meetings Agree that the Treasury undertake the first phase of the work programme outlined	Thursday 19 March 2020

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact	
David Stanley	Principal Advisor, Commercial Performance	[39]	[35]	✓
Shelley Hollingsworth	Manager, Commercial Performance			

Minister's Office actions (if required)

Return the signed report to Treasury

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Kiwi Group Holdings: Engagement and work programme

Executive Summary

The purpose of this report is:

- a to support you in your preparations for intended engagements with the shareholders in Kiwi Group Holdings Limited (KGH) and with KGH's board and management, and
- b to confirm your commissioning of advice during the meeting you had on Thursday 20 February 2020 with NZ Post and outline our proposed timeframes and scope for that work.

This report follows the Thursday 20 February 2020 meeting you had with Rodger Finlay and John Sproat, the Chair and a director of New Zealand Post Limited (NZ Post) respectively (and which was attended by Treasury officials), to discuss NZ Post's objectives and intentions regarding its 53% interest in KGH – the largest investment of which is Kiwibank Limited (Kiwibank).

NZ Post and the Treasury were invited:

- to propose creative solutions regarding NZ Post's stake in KGH (and Kiwibank), and
- to consider how (or whether) the Government's objectives would or could align with the strict commercial mandate that KGH and Kiwibank currently have.

You intend to meet with the two other shareholders in KGH, and with the Chair and General Manager of KGH itself, to test their thinking with regard to KGH and Kiwibank in order to inform the Government on its options. This report contains suggested talking points for those meetings.

Having gained more clarity on the nature of objectives that the Government is seeking, and ahead of any potential meetings with the Accident Compensation Corporation (ACC) and New Zealand Superannuation Fund (NZSF), the Treasury has prepared a proposal for a potential work programme of advice.

If you agree, we propose to undertake a two phase work programme in relation to:

- A the relative merits of three potential forms for implementing Government objectives for Kiwibank (and other KGH subsidiaries) – i.e. through changing the purpose statement, contracting for services or establishing a specific purpose subsidiary company,
- B the prospective ownership and governance arrangements which could deliver those objectives, and
- C negotiating strategies for achieving ownership changes in light of various existing KGH shareholders' perspectives (as a result of the insights you gain at meetings with them).

Phase 1 would develop advice at a higher level (and mostly using in-house resources) during March and April 2020. If Ministers then approve a move to Phase 2 (over May and June 2020), the work would involve wider engagement to test the merits of options developed in Phase 1 and would include a negotiating strategy (in part informed by your exploratory meetings with KGH and its shareholders).

A summary of the proposed work streams is on pages 9 and 10.

Recommended Action

We recommend that you:

- a **note** the suggested talking points on pages 7 and 8, to support your exploratory engagements with KGH shareholders

AND EITHER

- b **agree** that the Treasury undertake Phase 1 of the work programme outlined in the report

Agree/Disagree.
Minister of Finance

Agree/Disagree.
Associate Minister for State Owned Enterprises

OR

- c **agree** to meet with the Treasury to discuss what support you require to advance KGH-related matters

Agree/Disagree.
Minister of Finance

Agree/Disagree.
Associate Minister for State Owned Enterprises

Shelley Hollingsworth
Manager, Commercial Performance

Rt Hon Winston Peters
Minister for State Owned Enterprises

Hon Grant Robertson
Minister of Finance

Hon David Parker
Associate Minister of Finance

Hon Shane Jones
Associate Minister for State Owned Enterprises

Treasury Report: Kiwi Group Holdings: Engagement and work programme

Purpose of Report

1. The purpose of this report is:
 - a to support you in your preparations for intended engagements with the shareholders in Kiwi Group Holdings Limited (KGH), and with KGH's board and management, and
 - b to confirm your commissioning of advice during the meeting you had on Thursday 20 February 2020 with NZ Post and outline our proposed timeframes and scope for that work.

Background

2. On Thursday 20 February 2020, you had a meeting with Rodger Finlay and John Sproat, the Chair and a director of New Zealand Post Limited (NZ Post) respectively (and which was attended by Treasury officials), to discuss NZ Post's objectives and intentions regarding its 53% interest in KGH – the largest investment of which is Kiwibank Limited (Kiwibank).
3. At that meeting, you were clear that ownership of a bank was a key component for achieving Government objectives in the banking sector. However, NZ Post also reiterated the fact that it is no longer in a position to be the vehicle to retain an interest in, or to contribute to the future of, KGH. NZ Post's Chair stated that the company wants to divest its stake in KGH as soon as possible enabling it to focus on its core activities.
4. We heard your view that any change in shareholding arrangements represents a potential opportunity to reset the objectives of KGH (especially in relation to Kiwibank) and that a Government-owned bank should better differentiate itself from the larger banks in the market in contrast to Kiwibank's current emphasis, which appears to be to perform more like those banks.
5. [25]
6. NZ Post and Treasury officials have been invited:
 - to propose creative solutions regarding NZ Post's stake in KGH (and Kiwibank), and
 - to consider how (or whether) the Government's objectives would or could align with the strict commercial mandate that KGH and Kiwibank currently have.
7. You intend to meet with the two other shareholders in KGH, and with the Chair and General Manager of KGH itself, to test their thinking with regard to KGH and Kiwibank in order to inform the Government on its options. This report contains suggested talking points for those meetings on pages 7 and 8.

8. Having gained more clarity on the nature of objectives that the Government is seeking, and ahead of any potential meetings with the Accident Compensation Corporation (ACC) and New Zealand Superannuation Fund (NZSF), the Treasury has prepared this background note for you. This note is essentially high level and outlines a potential work programme of advice.

Some options for a Government seeking broader objectives from its bank

Any government-owned bank

[25], [37]

10. There are pros and cons with each of the options outlined above which the Treasury proposes to evaluate in subsequent advice (as described later in this report).

Kiwibank

11. The potential scope of Kiwibank's activities may also be a factor for consideration. This may best be thought of in three life stages for the bank:

- i [25], [26] and [37]

- ii

[25], [26] and [37]

- iii Long term future stage: The long term vision for Kiwibank in its “mature” stage.
12. [25]
13. We also note that Kiwibank’s parent company KGH owns other businesses, most notably Kiwi Wealth and Kiwi Insurance. [25], [37]
- i As the 6th largest KiwiSaver institution, Kiwi Wealth plays an important role in the personal long term savings (and first home deposit savings) of New Zealanders.
 - ii Kiwi Insurance is a relatively small participant in the insurance sector but there may be scope for it to play a greater role in the future. Currently, Kiwi Insurance is an insurance intermediary (not an underwriter) selling insurance products underwritten by The Holland Insurance Company Pty Limited.
14. Ahead of Ministers finalising any strategy for [25], [37], we recommend a two-step approach be taken for engaging with the other two KGH shareholders:
- i Exploratory meetings with each of ACC and NZSF, those meetings to occur separately, and then
 - ii Formal engagement to achieve the Crown’s objectives once negotiating strategies have been finalised.
15. If Ministers agree, the Treasury proposes to provide advice as described on pages 9 and 10.

Considerations in regards to objective broadening

16. [25] and [26]

In addition, the agreement between the KGH shareholders and the Crown (the Crown Deed) sets out the terms for transactions between shareholders (at any time) and with third parties and the Crown (after 31 October 2021). Further background on these agreements is included in our advice on 29 October 2019, *Expectations regarding NZ Post’s KGH investment* [T2019/3267 refers] and in Appendix 1.

17. [25], [37]

18. Similarly, for the Crown to acquire New Zealand Post's shareholding in KGH, the other two KGH shareholders (ACC and NZSF) will need to be prepared to give up their priority rights to acquire KGH shares. If they so agree, they may seek economic compensation for doing so, the extent of which may depend on the degree of negotiating leverage each side has. It is also possible that the three KGH shareholders act in concert to maximise the value they receive on divestment as this would be consistent with both the KGH Shareholders' Agreement as well as each shareholder's own legal obligations.
19. While NZ Post has already indicated its desire to divest its remaining interest in KGH and its willingness to return to the Crown a portion of any proceeds, both ACC and NZSF, as financial investors, would retain and reinvest any proceeds arising should they also sell – consistent with their respective organisational objectives. For these entities to alternatively retain their investments, accept the Crown as a shareholder in KGH (replacing NZ Post) and agree to a broadening of objectives, will require careful negotiation – and could require some incentives. If so, incentives might take the form of future capital commitments by the Crown, but they need not be limited to matters directly relating to KGH or its subsidiaries. The Treasury intends to include a more detailed consideration of possible negotiating strategies and incentive options in subsequent advice (as described below).

Step 1: Exploratory meetings with ACC, NZSF and KGH

20. There is a sound basis for Ministers seeking to meet with the shareholders and management of KGH from time to time. This is because:
 - While the current shareholding arrangements mean that there are a number of independent boards between the Crown and Kiwibank, it is possible that each shareholder intends its ownership to be for a finite term. In contrast, the Crown is expected to remain the ultimate owner (possibly with more direct ownership) in the future.
 - The Crown also provides KGH with a \$300 million uncalled capital facility (and KGH has a \$300 million back-to-back facility with Kiwibank).
 - The recent changes to the RBNZ capital requirements for New Zealand-registered banks include provision for some qualifying capital to be raised from third parties. The Crown will be interested to ensure that the terms on any such capital do not compromise the Crown's ultimate 100% ownership position.
21. The purpose of such meetings would be for Ministers to gain up-to-date insights into KGH shareholder and management thinking as to their ownership and performance objectives for KGH and Kiwibank, how they consider the business is performing in relation to those objectives and what their current thinking is in respect of near term and long term ownership arrangements.
22. It is quite possible that there are differences in the perspectives of each shareholder and of KGH itself, so we recommend that Ministers meet each party separately. This likely offers greater opportunity to draw out the objectives and intentions of each party.
23. You might enquire about:
 - i *How well they consider KGH overall (and Kiwibank in particular) is performing relative to expectations and whether there are any particular strategic or operational highlights or concerns.* Possible prompts might be in relation to the Te Ara Hou IT project or the recently finalised changes to the RBNZ requirements.

- ii *KGH's current projections for capital requirements over the next 3-5 years, and the likely timing of any future requests for new capital (including for alternative tier 1 capital sought from third parties).*
 - iii *The degree of comfort the shareholders have with their current exposure, whether they currently expect to provide all additional capital for KGH themselves, or whether they will be seeking new capital contributors in time.* This line of questioning provides an opportunity to broach the topic of current shareholder and Crown agreements before and after the lock-up date of 31 October 2021.
 - iv *View on the effectiveness of current governance arrangements and whether there are any specific measures that would assist in strengthening these.*
24. This line of questioning might open up an avenue for discussion of NZ Post's current ownership situation and the extent to which KGH shareholders and/or management consider the current ownership arrangements might hinder that shareholders' ownership objectives. If a KGH shareholder does open up this line of discussion, you might enquire:
- i *What the KGH shareholder considers to be practical solutions or pathways to modify current arrangements, and*
 - ii *(If a KGH shareholder expresses an interest in the Crown having a more active or direct interest in KGH) what form the shareholder considers Crown involvement might take and how the Crown could reconcile increased involvement with its broader wellbeing objectives.*
25. We recommend only pursuing that path in exploratory discussions if led there by a KGH shareholder. Currently the best avenue to achieving variation in current arrangements is if this is something the KGH shareholder indicates interest in. Proactive prompting on the government's part could be interpreted by KGH shareholders as providing them negotiating leverage due to their current priority rights – and could lead to more protracted negotiations and a higher acquisition cost for the Crown in any subsequent negotiating phase.
26. We recommend that Ministers do not pursue any line of enquiry which indicates or implies that the Crown already has a preferred course of action. This includes not leading the conversation into territory which would require KGH shareholders to agree changes to the KGH Shareholders' Agreement and the Crown Deed.

Step 2: Preparation of objectives and the negotiating strategy

27. We expect that your exploratory meetings with KGH shareholders and management will aid in determination of more formal later engagement once your preferred arrangements for delivering Crown objectives for Kiwibank have been more fully formed and a negotiating strategy has been developed.
28. Objectives and negotiating strategies will be able to take account of the preparedness, or not, of KGH shareholders to partner more directly with the Crown in the ongoing development of Kiwibank (and other KGH subsidiaries).
29. The Treasury proposes a work programme to support your objectives and negotiating strategy formulation as described below.

Possible nature of a Treasury work programme

30. If Ministers agree, we propose to undertake work in two phases

Phase 1 – March and April 2020

31. **Part A:** Developing advice [25], [37]

This work could be undertaken by the Treasury Commercial Performance team, consulting on parts with the Treasury Financial Markets and Financial Institutions teams but not engaging with any external parties (such as the RBNZ or KGH and its shareholders) unless Ministers wish there to be early engagement with those external parties. We note that Treasury teams a number of other high priority projects underway such as COVID-19, KiwiSaver and Insurance-related matters and so we will be keeping in mind resource requirements for those work streams.

32. It is not currently envisaged that the Treasury undertake any detailed evaluation of policy options. General background advice in relation to policy objective considerations is in our 22 November 2018 report *Banking sector competition and profitability* and our 13 June 2019 report *Kiwibank ownership strategy and the banking sector* [T2018/3294 and T2019/1504 refers, respectively].

33. The work in part A would, however, need to outline aspects within any potential objectives set which might enhance or conflict with existing banking sector regulations and any changes currently under consideration.

34. **Part B:** Ownership and governance options for the Crown in light of the Government's objectives and existing KGH shareholders' perspectives. This work would also draw on Treasury's internal resources (including its legal team) but early engagement of an external legal advisor would be recommended so as to enable early identification of any more complex matters that might need to be worked through. The firm that advised the Treasury in relation to the negotiations that introduced ACC and NZSF as shareholders of KGH (Project Tui) would likely be well placed to do this.

35. This advice could include a (high-level and indicative) prospective timeline for, and key elements of, a proposed negotiating strategy.

36. **Part C:** Value and cost considerations. We propose to provide some relatively high level information on the current market value of KGH based on market trading prices for comparable Australasian banks and on control premiums in takeover bids. In addition, we expect to firm up the estimates of prospective capital requirements for KGH over the period to June 2026. Current formal estimates we have from KGH were produced prior to the release of the RBNZ's final decision on capital requirements for registered banks.¹

[25]

Phase 2 – May and June 2020

37. If you then approved a move to Phase 2, we would more widely engage to test the merits of the options outlined in Phase 1. This phase would also involve development of a negotiating strategy – including more detailed consideration of business valuation and potential cost.
38. Phase 2 is oriented toward a potential major transaction and a resulting post-transaction organisation objectives framing component. Therefore, we consider it likely that external investment banking expertise would need to be added (as was the case for Project Tui) as well as direct engagement with external parties (such as the RBNZ given its system oversight role). The Treasury would likely also need to draw upon additional resources for the duration of the project – the extent and nature of these resources being informed by the work undertaken during Phase 1.
39. However, it is also possible that ACC and NZSF indicate in your exploratory meetings with them that they seek a pathway to changed ownership arrangements [25], [37]. In this case, Phase 2 would be more straightforward and functional – requiring minimal negotiation and the components of, and timeframe for, Phase 2 could be significantly truncated.

Appendix 1: Key current ownership and transaction-related arrangements between KGH shareholders and between the shareholders and the Crown

Board representation and ownership of KGH

- It is up to the shareholders of KGH to determine the appointment of directors to the KGH board, with the extent of their representation being determined by the KGH Shareholders' Agreement.
- The KGH Shareholders' Agreement provides that the Board comprises a minimum of three directors and a maximum of five directors, and that representation on the Board is based on the level of shareholding in the company as shown in Figure 1.

Figure 1: KGH director representation based on shareholding

Shareholding in KGH	Number of directors
Less than 20%	One director if all other shareholders approve
20% to 39.99%	One director
40% to 59.99%	Up to two directors
60% to 79.99%	Up to 3 directors
80% or more	Up to four directors

- Specific exceptions to the shareholding-based representation shown in Figure 1 were provided for on the completion of Project Tui. Under those provisions, NZ Post initially has up to 3 directors – a majority of the directors on KGH (notwithstanding it having less than a 60% shareholding). Were NZ Post's shareholding to fall below 50%, or if the beneficial ownership of that holding were to change, the standard provisions would apply. NZ Post could also elect to appoint less directors at any time.
- The Crown Deed is the main document relating to ownership of shares in KGH (and transfer of shares which is dealt with in a subsequent section). The Deed also applies to transfers of Kiwibank shares. The Deed provides that each of NZ Post, NZSF and ACC will keep the Crown and each other informed of their intentions in respect of the ownership of KGH from time to time.

Marketplace for KGH shares and their valuation

Agreements between KGH shareholders and the Crown

- Agreements relating to share transactions are contained in the Crown Deed to which NZ Post, ACC, NZ Super and the Crown are signatories. This Deed was part of arrangements put in place at the time of the Project Tui transaction to:
 - provide for a (limited) marketplace for the shareholders of KGH to transfer shares (and for the Crown to participate directly after 31 October 2021). At the time, this was deemed to be beneficial to NZ Post which might seek to reduce its holding over time to provide funds for its core businesses, and for both NZ Super and ACC which indicated that they were potential acquirers of shares over time; and to
 - ensure that KGH and Kiwibank remained 100% within Crown (direct or indirect) ownership for at least the succeeding five years and that beyond 31 October 2021 (the five-year anniversary), the Crown could retain that level of ownership through specific mechanisms if it so chose.

Share transactions near-term and long term

- The Crown Deed provides that no KGH shareholder may transfer shares (including a beneficial or legal ownership of those shares) before 31 October 2021 unless the transfer (and transferee) are approved by all other shareholders, and provided that the transferee agrees to be bound by the Crown Deed and the KGH Shareholders' Agreement.
- Transfers of shares between existing shareholders is permitted at any time and is permitted between shareholders and the Crown after 31 October 2021 as long as specific provisions relating to transfers are adhered to. There are provisions for establishing the price for such transfers.
- The Crown Deed makes specific provision in the event that NZ Post is the selling shareholder including that:
 - NZ Post shall be entitled to sell shares to ACC and/or NZSF without the consent of the Crown, and
 - NZ Post can sell its shares to the Crown (or to other KGH shareholders) after 31 October 2021 unless it has already issued a notice of intention to sell to an existing shareholder. However, existing KGH shareholders have priority rights over any shares offered for sale. As the Crown is not currently a shareholder, this means that ACC and NZSF would first decide whether or not they wished to own additional shares.
- The Crown Deed provides for the issue of new shares in KGH or Kiwibank to meet capital requirements (for whatever reason). The Deed also contemplates the possibility of an issue of shares as part of an Initial Public Offering (IPO) at some time in the future or to a third party outside the Crown estate, but
 - In no case may this occur prior to the end of the lock-up period (31 October 2021), and
 - The Crown has pre-emptive rights to acquire the shares in KGH or Kiwibank rather than have the IPO or transfer to a third party proceed.
- The Deed lays out processes for establishing the price for any share issues or transfers.

Appendix 2: Current ownership and governance arrangements

