

The Treasury

Project Korimako - Release of advice

December 2022

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- [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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Treasury Report: Project Korimako - Draft Cabinet Paper

Date:	11 November 2021	Report No:	T2021/2708
		File Number:	SE-2-12-4-2-3

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree that the NZSF proposal should be recommended to Cabinet Consider the attached draft Cabinet paper and provide feedback	Wednesday 17 November 2021
Associate Minister of Finance (Hon Dr Megan Woods)	Note the contents of the report	Wednesday 17 November 2021
Associate Minister of Finance (Hon David Parker)	Note the contents of the report	Wednesday 17 November 2021

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: Yes - [Project Korimako Cabinet Paper \(Treasury:4582052v1\)](#)

Executive Summary

You agreed to us asking the New Zealand Superannuation Fund (NZSF) to submit a revised ownership proposal for Kiwi Group Holdings (KGH) that is consistent with the Government's views regarding the ability to maintain KGH ownership within the Crown [33], [37], [38] [T2021/1832 refers]. Following workshops with officials, NZSF has submitted its indicative proposal. NZSF indicates that it is prepared to buy up to 100% of KGH (dependent on the prices at which shares become available)¹, [33], [37], [38]

The NZSF proposal is due to be confirmed by NZSF's Board on 23 November. Recognising your intention to obtain Cabinet decisions on the preferred KGH ownership arrangements before the end of the year, allowing for negotiations to proceed in the first half of 2022, a draft Cabinet paper is attached for you to consider in parallel to the NZSF's governance process. The intention is that the paper only be lodged for Cabinet Committee after NZSF's Board has confirmed the proposal.

Ownership Options

We have assessed two alternative ownership options for KGH: NZSF's indicative proposal; and the Crown directly acquiring majority ownership of KGH.

[25], [37]

- [25], [37] [33], [37], [38]
- [25], [37]
-
-

[25], [37]

[33], [37], [38]

[25], [37]

[25], [37]

¹ [33]

[25], [37]

Under the alternative of **direct majority Crown ownership** of KGH, it would be necessary to determine the best strategy to achieve this objective. Several scenarios are possible for direct ownership through either working within the current Crown Deed process or making an offer outside of this arrangement. It would be necessary to carefully consider these alternatives and so specialist commercial transaction and legal advisors would be put in place.

Assessment Criteria

We have assessed the options against the following criteria to assess their ability to deliver against the Government's expectations:

- **Kiwibank as a disruptor:** supporting Kiwibank to be a genuine competitor in the banking industry with consequent benefits for banking consumers;
- **Crown ownership:** Government can ensure that KGH remains wholly New Zealand-owned and (directly and/or indirectly) at least majority Crown-owned;
- [33], [37], [38]
- **Cost:** impacts on the core Crown and the Crown balance sheet; and
- [25]

Summary of Assessment

A summary of the pros and cons of the ownership options considered in this paper is as follows.

NZSF Proposal	Crown Direct Ownership Options
<p>Pros</p> <ul style="list-style-type: none"> NZSF is well placed to provide capable ownership and governance during Kiwibank's key transformation period and the growth capital required. Assuming a \$2bn² implied value for 100% of KGH, NZSF purchasing NZ Post's shares would <u>reduce</u> gross sovereign-issued debt and core Crown debt by around [25]. [33] [33]. [37]. [38] NZSF and other remaining shareholders would be responsible for funding ongoing capital requirements of Kiwibank which NZSF estimates to be [25] <p>Cons</p> <ul style="list-style-type: none"> [33], [37], [38] The Crown Deed gives the Crown the ability to ensure ownership remains within the Crown through its ability to purchase shares before they can be sold externally but this is less secure than direct Crown ownership. 	<p>Pros</p> <ul style="list-style-type: none"> [33], [37], [38] Direct ownership is the most secure means of ensuring ongoing Crown ownership. [25] <p>Cons</p> <ul style="list-style-type: none"> [25], [34] The increased monitoring arrangements required under this option would be significant, recognising the regulatory and compliance requirements specifically applying to banking. Assuming a \$2bn implied value for 100% of KGH, the Crown purchasing 100% of KGH directly would <u>increase</u> gross sovereign-issued debt and core Crown debt by [25] and ongoing capital requirements would fall on the Crown and compete against other Budget priorities.

Treasury recommends that NZSF's indicative proposal be supported

NZSF's indicative proposal is the most likely option to encourage a successful future for KGH and it reduces capital and transaction costs for the core Crown (although there is a potential significant future capital and transaction cost to maintaining NZ and/or Crown majority ownership). [33], [37], [38]

and

maintaining the Crown's pre-emptive purchase rights. [25], [33], [37] and [38]

The attached draft Cabinet paper is provided for your consideration. It has been written on the basis that you support NZSF's proposal. The paper asks Cabinet to endorse your view on the Government's preferences regarding KGH ownership. The paper outlines the alternative scenarios and why these are not preferred and then outlines for Cabinet the steps that you will take if Cabinet endorses the recommended preferences.

² A \$2 billion implied value for 100% of KGH has been used but actual transaction prices are the subject of negotiations yet to occur and therefore actual values if, and when, transactions occur are uncertain.

³ [25]

Recommended Action

We recommend that you:

- a **agree** that the NZSF proposal should be recommended to Cabinet as the preferred ownership option for KGH, following confirmation of the proposal by the NZSF board

Agree/disagree.
Minister of Finance

- b [33], [37], [38]

- c **consider** the attached draft Cabinet paper and provide any feedback.

Agree/disagree.
Minister of Finance

Shelley Hollingsworth
Manager, Commercial Performance

Hon Grant Robertson
Minister of Finance

Hon Dr Megan Woods
Associate Minister of Finance

Hon David Parker
Associate Minister of Finance

Treasury Report: Project Korimako - Draft Cabinet Paper

Purpose of Report

1. This report assesses the New Zealand Super Fund's (NZSF's) indicative proposal to negotiate to purchase a majority shareholding in Kiwi Group Holdings (KGH). It compares the merits of that proposal to the alternative option of direct Crown majority ownership. Attached for your consideration is a draft Cabinet paper that asks Cabinet to endorse your view on the Government's preferences regarding KGH ownership.

Background

2. Treasury officials have held further discussions with NZSF and asked it to submit a revised ownership proposal for KGH that is consistent with the Government's views regarding the ability to maintain KGH ownership within the Crown [33], [37], [38] [T2021/1832 refers].
3. Officials held workshops with NZSF staff to outline and clarify the Government's preferences regarding the outcomes that new ownership arrangements should target. NZSF was asked to prepare its preferred ownership proposal as well as indicating the lowest ownership percentage it would be prepared to own. Any proposal would need to include mechanisms to ensure that the Crown can ensure the retention of Crown ownership in the future.
4. NZSF has now presented its indicative proposal. The proposal is scheduled to be confirmed by NZSF's Board on 23 November. Recognising your intention to obtain Cabinet decisions on the preferred KGH ownership arrangements before the end of the year, allowing for negotiations to proceed in the first half of 2022, a draft Cabinet paper is attached for you to consider in parallel to the NZSF's governance process. The intention is that the paper only be lodged for Cabinet Committee following confirmation of the proposal by NZSF's Board.
5. Ministers should note that any of the options in this report describe a potential outcome but there is no certainty that options will play out as envisioned. Under each option parties will need to negotiate and there is no certainty that sellers and acquirers will agree to terms, with price being the most likely potential sticking point. For example, if NZSF's proposal is endorsed it will then seek to negotiate with NZ Post. For negotiations to be successful, there will need to be agreement on terms (including price), [33]

NZSF investment committee and Board approval, NZ Post Board approval and, likely, NZ Post shareholding Ministers' approval of a major transaction. If NZSF was unable to successfully conclude negotiations we would reconsider the optimal approach for the Crown at that time, noting that direct Crown ownership would most likely become the most likely outcome. [38]

6. We outline the potential ownership options for KGH below and the criteria we will use to assess them. We then consider the merits of the alternative options.

Ownership Options

7. The options for consideration are NZSF's indicative proposal to negotiate to purchase a controlling stake in KGH and potential pathways to the Crown acquiring direct majority ownership of KGH.
8. We have not included the status quo in our assessment as we do not see the status quo as a viable longer-term option. This is because:
 - two current KGH shareholders (NZ Post and ACC) have indicated a preference to sell, and the third has indicated that if its proposal to acquire a controlling position is not successful then it may consider divestment;
 - the 5-year lock up period ended on 31 October 2021 and, other than by Shareholding Ministers stating expectations to NZ Post, there are no real constraints on shareholders investigating whether there is a market for their shares beyond the Crown. [37], [38]

A sale at the current book value of NZ Post's 53% KGH stake would be a major transaction;

- [25] and [37]

-

NZSF's Proposal

9. NZSF has developed its proposal within the context of the existing Crown Deed applying to KGH ownership. This document determines the rights of each of the parties with respect to selling and purchasing shares in KGH. These arrangements took substantial time and effort to negotiate ahead of the current ownership arrangements being established in October 2016. Minimising the extent of amendments required should aid the process toward new arrangements as the framework for negotiation, share transfer and ownership would already be largely agreed.
10. [25], [37]
 - [25], [37] [33], [37], [38]

 - [25], [37]

 -

⁴ [33]

- [25], [37]

11. [25], [37]

[33], [37], [38]

[25], [37]

12. [25], [37]

Direct Crown Majority Ownership

13. There would need to be a co-ordinated Crown strategy if its preference is for direct majority Crown ownership of KGH and so the Treasury is preparing the ground for this eventuality (as discussed in Next Steps below). It would be necessary to carefully consider alternative strategies including receiving specialist commercial transaction and legal advice.

14. [38]

Assessment Criteria and Analysis of the Ownership Options

15. Our criteria for assessing the options against their ability to deliver against the Government's expectations are as follows:

- **Kiwibank as a disruptor:** how does each option support the goal for Kiwibank to be a genuine competitor in the banking industry capable of increased lending to retail and the SME market and improved accessibility for its customers through a new market-leading technology platform. Kiwibank's ability to be a disruptor bank depends not just on the quality of its systems and processes and the way it marshals its resources (human, capital and other) but also the total financial resources available to it;
- **Crown ownership:** ensuring the Government's requirement that KGH (and Kiwibank) remain New Zealand-owned with at least a majority of the shares remaining (directly or indirectly) within the Crown;

[25], [37]

- [33], [37], [38]
- **Cost:** while all transacting parties are within the broader Crown there are different impacts on the core Crown and the Crown balance sheet; and
- [25]

16. Our analysis of the options against the assessment criteria is contained in figure 1 [33], [37], [38]

Figure 1: Assessing Ownership Options Against the Criteria

Criteria	NZSF Control	Crown Direct Ownership
Kiwibank as a Disruptor	Provides the capable ownership and governance needed to support Kiwibank during its transformation period, and the ability to capitalise Kiwibank adequately to enable the scalability it needs to be a genuine competitor in the banking industry. Provides the best chance of Kiwibank becoming capable of increased lending to its core retail market and the SME market and improved accessibility for its customers through a new market-leading technology platform.	[25], [34] The Crown also has many other competing priorities for its resources than growth capital for the business.
New Zealand Ownership and at least majority (direct or indirect) Crown-owned	The Government controls whether shares are sold outside of the Crown as any sales of shares must first be offered to other KGH shareholders and then to the Crown ⁶ . Only if the Crown declined to purchase them could they then be offered to shareholders outside the Crown ⁷ . NZSF must retain a minimum KGH shareholding of 50.1% for five years.	Crown directly controls ownership so shares could only be sold outside of the Crown if the Government decided to sell.
[33], [37], [38]		
Cost (based on assumed indicative value for KGH of \$2 billion)	[25] [33], [37], [38] NZSF and other remaining shareholders would be responsible for funding ongoing capital requirements of KGH [25]	[25] Ongoing capital requirements [25] would fall on the Crown [33], [37], [38] and compete against other Budget priorities.

⁶ If NZSF became a 100% owner of KGH, the KGH Shareholders' Agreement (which the Crown is not a signatory to) would cease but the matters relating to share transfers and lock-up arrangements are contained in the Crown Deed which would continue.

⁷ [33], [37], [38]

	<p>[25]</p> <p>If the Crown was to purchase KGH in a few years, following the transformation programme, the purchase price would likely be significantly higher than purchasing KGH shares now (if the transformation is successful) reflecting improvements in Kiwibank's competitiveness and its increased size. NZSF's controlling stake might also carry a control premium value.</p>	<p>There would be transaction costs in negotiating and executing the share purchases.</p> <p>Purchasing KGH shares now would be cheaper than following a successful transformation programme, but this simply reflects the lower quality of the underlying business pre-transformation and that significant additional capital needs to be invested. It also reflects the risk that the transformation may be unsuccessful.</p>
	<p>The Crown would incur transaction costs (e.g. for professional advisors) of around \$2 million and possibly up to \$4m.</p>	<p>We estimate the Crown would incur transaction costs of around \$4 million and possibly up to \$8 million.</p>
<p>[25]</p>		

[33], [37], [38]

17. [33], [37], [38]

18.

19.

20.

21.

⁸ [25]

We consider NZSF's proposal to be the most likely option to encourage a successful future for KGH, it addresses the Government's requirements, and reduces initial costs for the core Crown

22. The Government's goals for KGH, and primarily its main subsidiary Kiwibank, are significant. Kiwibank requires a significant increase in its scale, efficiency, and cost competitiveness. This increased ambition, combined with the Te Ara Hou transformation and the need to meet increasingly demanding RBNZ requirements, best suit a commercially strong and focused owner [25], [37]. This owner needs to actively engage with the company and make timely commercial decisions, including for the provision of regulatory, growth and risk capital. We consider NZSF is better placed to fulfil this role as the controlling shareholder than the Crown.
23. We consider the provisions in the Crown Deed meet your requirement for assurance that KGH remain New Zealand owned and that a majority of KGH can be (directly or indirectly) retained within the Crown as the Crown retains its rights of refusal and so can purchase shares before they can be offered to external investors [33], [37], [38]
24. [33], [37], [38]
25. From a cost perspective, we also note that the Crown will incur significant share purchase costs under any scenario. However, their nature, timing and magnitude differs between:
- significant up-front costs for a Crown purchase and
 - significant costs in the future if or when NZSF reduces its investment (and with the future share value being determined by the extent to which Kiwibank is performing as a competitive market disruptor and the degree of control NZSF seeks to transfer).

NZ Post Considerations if it Divests from KGH

26. If NZ Post sells its entire 53% interest in KGH, this is likely to qualify as a major transaction under the Companies Act and require the approval of the NZ Post shareholding Ministers.
27. Treasury officials are continuing to engage with NZ Post regarding appropriate capital and financial structuring arrangements going forward. These discussions include consideration of post-KGH divestment arrangements including the payment of a special dividend (or any similar arrangement to reduce any excess capital post a KGH divestment).

28. For calculating the financial impact on the Crown in this report, we have assumed that NZ Post retains [25]

This is based on discussions with the company and analysis regarding its forward capital plans as provided in its 2021/22 business case (including its further investment in its parcels network and costs to restructure its mail business as the networks are integrated) and assuming the company could take on the appropriate level of debt such that it can retain a BBB investment grade rating (in line with Treasury's Owners Expectations guidelines).

29. [25]

Next steps

30. The NZSF Board is expected to consider the indicative proposal on 23 November. Considering the remaining dates this calendar year at which Cabinet could consider the matter, we have prepared the timetable in Figure 2 showing dates for next steps and key decision points.

31. [33]

32. Following Cabinet decisions, there will still be a number of steps before the preferred ownership arrangements for KGH will be finalised. The nature and timing of these subsequent steps will depend on the time taken for any negotiations to be successfully completed.

Figure 2: Indicative timetable for next steps

Date	Event
Thursday 18 November	Cabinet paper goes out for consultation.
Tuesday 23 November	NZSF Board considers indicative proposal.
By Thursday 25 November	NZSF confirms indicative proposal.
Thursday 2 December	Cabinet paper lodged.
Wednesday 8 December	Cabinet Economic Development Committee meeting.
Monday 13 December	Cabinet meeting.
Following Monday 13 December	Minister of Finance sends letter regarding decision on NZSF indicative proposal to NZSF Chair. Letters sent to other KGH shareholders advising of Crown decision on its ownership preferences for KGH.
From Thursday 16 December	If the Crown has endorsed an NZSF proposal , KGH shareholders can move to commence negotiations (including price negotiations) on possible changes to their shareholdings [33]

	[33]	[38]
	If the Crown's preference does not include NZSF as a majority shareholder in KGH, Treasury officials will prepare a KGH acquisition strategy for Ministers' consideration.	
November/December 2021	Begin procurement of external professional advisers – the specific arrangements after mid-December 2021 depend on Crown's preferred pathway forward and Cabinet decisions on transaction funding.	
From late December 2021	The current shareholders in KGH and the Crown engage with a view to finalising future arrangements in the first half of 2022.	
Second half of 2022	[33]	

33. The Treasury is now lining up procurement of commercial and legal advisors to support negotiation of whichever is the Crown's preferred path forward. Legal and financial services industry advisors have been involved in the process to date. While the appropriate commercial advice for a direct Crown purchase of a majority holding in KGH would be more extensive than under the NZSF proposal, both options will require transaction advice funding approval from Cabinet.
34. If you agree with our recommendation for the NZSF proposal to move forward, the external advisor team will support the Treasury:
- in negotiations on behalf of the Crown regarding the future lock-up arrangements for NZSF and maintaining on-going rights of refusal and information requirements (if NZ Post sells out of KGH and/or Kiwibank cancels the UCF);
 - [33], [37], [38]
 -
 -
35. If the Crown's preferred pathway involves direct purchase of a majority interest in KGH, professional advice would also include:
- supporting Treasury in negotiations on behalf of the Crown in determining alternative acquisition strategies and recommending a preferred strategy to the Government; and
 - supporting the actual negotiations [33], [37], [38]
36. In figure 3 below we outline the key steps ahead for which we would seek external professional support should NZSF's proposal progress.

Figure 3: Key steps for negotiations towards recommended ownership arrangements

Stage	Date	NZSF and ACC	Crown [33], [37], [38]
1	From December 2021	NZSF negotiating with NZ Post to acquire majority of KGH. NZSF negotiating contract with Crown for lock-up, information flows etc.	At the table for any negotiations between KGH shareholders. Engage with NZSF and ACC on ACC's divestment position [33], [37], [38]

			Begin contract negotiations for NZSF lock-up, information flows etc. [25] [33], [37], [38] Preparation for due diligence processes.
2	By end of Quarter 1 2022	If agreement is reached on price, NZSF secures majority of KGH (conditional on [33] board approvals). and [33], [37], [38]	[33], [37], [38] due diligence underway. [33], [37], [38]
3	Mid calendar 2022 (or possibly earlier)	NZSF investment committee, NZSF board, NZ Post board and, if a major transaction, NZ Post shareholder approvals (and ACC board agreement reached for an ACC sale). Transactions agreed [33]	[33], [37], [38] due diligence completed. [33], [37], [38] Ministers' approvals and report back to Cabinet or Cabinet approval. Transactions agreed [33]

¹ The ownership vehicle if the Crown owns shares in KGH appears likely to be a Schedule 4A company.

² [33]

37. If your preference is for the Crown to purchase all of KGH, we will prepare for you an outline of key negotiation steps on that basis.

Draft Cabinet Paper

38. The attached draft Cabinet paper has been written on the basis that you support NZSF's indicative proposal. The paper asks Cabinet to endorse your view on the Government's preferences regarding KGH ownership. The paper outlines the alternative scenarios and why these are not preferred then outlines for Cabinet the steps that you will take if Cabinet endorses the recommended preferences. The paper requests additional funding of \$4 million representing the transaction costs involved for professional advisors to represent the Crown's interests in negotiations, including to renegotiate the Crown Deed to include the new lock-up and information requirements [33], [37], [38]
39. [33], [37], [38]
40. If you do not support NZSF's proposal there may be no need to go to Cabinet if you are satisfied with the status quo prevailing for the immediate future. If you wished to take proactive action to position the Crown to become a direct majority shareholder, however, we would revise the Cabinet paper accordingly. We would then develop an acquisition strategy to identify the best approach to achieve direct Crown majority ownership [33], [37], [38] This will require advisory and transactions costs likely to be in the range of \$4 million to up to \$8 million. We would seek appropriations for this funding and authorisation to acquire a majority interest in KGH in the revised Cabinet paper.