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 ŌHANGA
THE TREASURY

Treasury Report: Project Korimako - Arrangements for Crown Shareholdings

Date:	13 April 2022	Report No:	T2022/707
		File Number:	SE-1-3-22

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Agree in principle** to establish a new company listed in schedule 4A of the Public Finance Act 1989 to hold KGH shares **Agree** to commence the process of identifying suitable directors	21 April 2022
Associate Minister of Finance (Hon David Parker)	**Agree in principle** to establish a new company listed in schedule 4A of the Public Finance Act 1989 to hold KGH shares **Agree** to commence the process of identifying suitable directors	21 April 2022

Contact for telephone discussion (if required)

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

Minister's Office actions (if required)

Return the signed report to Treasury. **Refer** report to Hon Dr Megan Woods if agreed.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Project Korimako - Arrangements for Crown Shareholdings

Executive Summary

This report analyses the alternative arrangements by which the Crown could hold shares it may purchase in Kiwi Group Holdings Limited (KGH) and recommends that a new Public Finance Act 1989 (PFA) schedule 4A company be established for this purpose.

After considering Public Services Commission guidance, our shortlist of options for consideration was direct ownership by shareholding Ministers, a Crown entity company, or a PFA Schedule 4A company. Each of these ownership options could be made to meet your overarching policy objectives for KGH so to choose between them we focused on the underlying merits of the three holding options as they relate to KGH.

While direct shareholding by Ministers would avoid the time and cost of establishing a new entity, we consider it would be more appropriate for such a significant Crown-controlled entity to have an ownership structure with reporting and accountability obligations akin to those under the PFA or the Crown Entities Act (CEA).

Crown entity and PFA Schedule 4A companies are proven and established mechanisms for the Government's commercial activities and are similar in many respects. We consider that the PFA Schedule 4A company regime would be more suitable for a Crown vehicle holding KGH shares. [36]

We estimate establishment of a new PFA Schedule 4A company would take at least five months. Treasury considers that this will still allow the KGH share purchase to proceed within your proposed timetable, through shareholding Ministers finalising share purchase arrangements by 30 June 2022 before the Crown vehicle is established (and, if necessary, the new vehicle proceeding with the transaction once it is incorporated, but before its listing on PFA Schedule 4A has been completed). In parallel we also propose to progress a backstop option of Ministers initially acquiring shares before they are later transferred to the new PFA Schedule 4 company upon its establishment. To maintain momentum, we recommend that you agree to us commencing now to identifying suitable directors for the company, initially focusing on an establishment chair and one additional director.

Recommended Action

We recommend that you:

a **agree in principle** to establish a new company listed in schedule 4A of the Public Finance Act 1989 to hold shares in Kiwi Group Holdings Limited

Agree/disagree. Minister of Finance	*Agree/disagree.* Associate Minister of Finance

b **agree** to commence the process of identifying suitable directors for the proposed new company, with a particular focus on an establishment chair and one director

Agree/disagree. Minister of Finance	*Agree/disagree.* Associate Minister of Finance

c **refer** this report to Hon Dr Megan Woods for her information

Yes/no.
Minister of Finance

Shelley Hollingsworth
Manager, Commercial Performance

Hon Grant Robertson
Minister of Finance

Hon David Parker
Associate Minister of Finance

Purpose of Report

1. This report analyses the alternative arrangements by which the Crown could hold shares it may purchase in Kiwi Group Holdings Limited (KGH) and recommends that a new Public Finance Act 1989 (PFA) Schedule 4A company (a Crown vehicle) be established for this purpose.

Background

2. The Government's intention is to pursue direct majority Crown ownership of KGH, as a step towards putting in place long-term ownership arrangements for KGH [DEV-22-MIN-0051 refers]. Discussions have commenced with KGH shareholders with the intention of reaching agreements with those parties by 30 June 2022.

3. At present the Crown has a 100% interest in KGH but this interest is through three other entities, namely New Zealand Post Limited (NZ Post), New Zealand Superannuation Fund (NZSF), and Accident Compensation Corporation (ACC). KGH shareholders are now free to sell their KGH shares, with the Government's only ability to exert direct control over that process being through the contractual pre-emptive purchase rights it has before the shares can be offered to an external party.

4. We have been referring to the proposed new shareholding arrangements as direct Crown ownership. By "direct" ownership we are referring to KGH shares being held either directly by the Crown, or by an entity wholly owned by the Crown. We consider the merits of the various holding options with respect to the Government's policy objectives below.

Options

5. The Public Service Commission has provided guidance on the appropriate organisational form for Government entities[1]. Its advice regarding entities with commercial functions is depicted in Figure 1 and includes four entity types:

   a a Crown entity company under the Crown Entities Act 2004 (CEA),

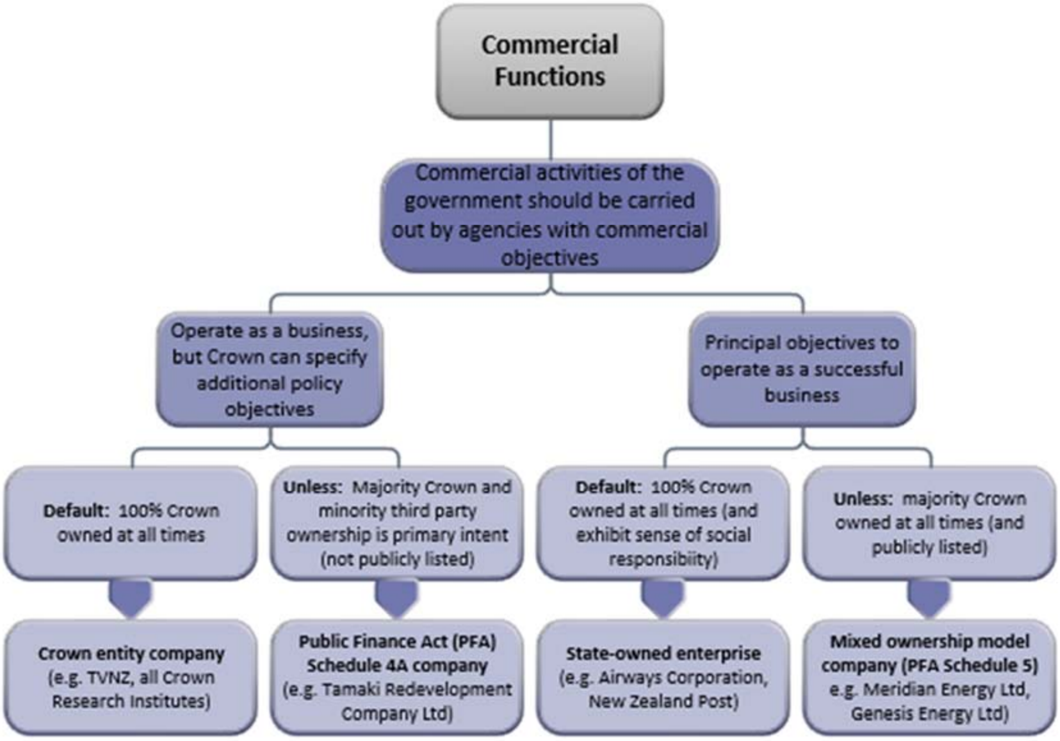
   b a company listed in Schedule 4A of the PFA,

   c a SOE under the State-Owned Enterprises Act 1986, and

   d a mixed ownership model (MOM) company under Schedule 5 of the PFA.

1 https://www.publicservice.govt.nz/assets/SSC-Site-Assets/SAPG/mog-supp-guidance-design-choices.pdf

Figure 1: Public Service Commission Guidance on Organisational Form for Commercial Functions



6. In addition to these four options, we have also considered direct ownership of KGH shares by shareholding Ministers (i.e., no holding entity vehicle).

7. Of this full list of options, we consider it possible to immediately exclude the MOM and SOE organisational forms. The holding vehicle for KGH shares will not be publicly listed so the MOM structure is inapplicable. Similarly, SOEs are intended to be operational businesses rather than passive holding vehicles. No holding companies previously established by the Government were established as SOEs.

8. Our shortlist for consideration is therefore direct ownership by shareholding Ministers, a Crown entity company, or a PFA Schedule 4A company.

[33], [37], [38]

9. [33], [37], [38]

[33], [37], [38]

10.

Removal of KGH

11. We have also considered the option of removing KGH from the structure, [33], [37]

We see few benefits to this option. It would add complexity and significant time to the process of establishing the new Crown vehicle, while losing the advantages of having a holding company for a registered bank and any other KGH subsidiaries (such as making collective decisions about the underlying businesses).

Assessment of options against the Crown's objectives

12. Your December Cabinet paper [CAB-21-MIN-0528 refers] identified the following primary objectives as the criteria for assessing ownership options for KGH:

   a Long term New Zealand ownership of Kiwibank: ensuring the Government's requirement that Kiwibank remains New Zealand-owned with at least a majority of the shares remaining (directly or indirectly) within the Crown,

   b [25]

   c For Kiwibank to be a disruptor bank while also acting commercially (as a minimum the need for the bank to continue to be self-sustainable): supporting Kiwibank to be a genuine competitor in the banking industry,

   d [33], [37], [38]

   e Cost: [33], [37], [38] there are different impacts on the core Crown and the Crown balance sheet.

13. We are comfortable that each of the holding options under consideration can meet these objectives to some degree.

   a ***Long-term Ownership:*** Under each option any decision to sell the Crown's KGH shares would require an explicit Government decision.

   b [25]

   Under the Crown entity company or PFA Schedule 4A options, while the Government would not have the ability to directly appoint KGH and Kiwibank board members, Ministers would appoint the board of the Crown vehicle which would, in turn, appoint directors to KGH and through KGH have influence on the Kiwibank board appointment process. Ministers would define the Crown vehicle's purpose and functions (including permitted or restricted activities), upon establishment of the entity and adoption of its constitution. They would also express their objectives for the entity through a letter of expectations that would translate into the entity's Statement of Intent.

c **_Kiwibank as a disruptor:_** This objective relates to Kiwibank being supported to enhance its competitiveness, through supportive shareholders providing expertise and additional capital for Kiwibank to improve its productivity and increase market share. The impact of the Crown as a KGH shareholder on this objective is more likely a function of the attitude that the Crown takes to supporting Kiwibank to improve its performance rather than the form in which the Crown shareholding is held. There may be an argument, however, that it is easier to ensure supportive arrangements for commercial performance are in place at arms-length to Government Ministers through a Crown vehicle structure.

d [33], [37], [38]

e **_Cost:_** This objective was referring to the decrease in core Crown debt that would have occurred if NZSF had purchased KGH, so is less relevant in the current context. There would be some additional cost implications from the Crown entity company and PFA Schedule 4A options as those entities would require a funding stream to cover Board and operational expenses.

14. Given that policy objectives can be met under each of the options, we have considered the underlying merits of the three holding options as they relate to KGH.

Direct holding by shareholding Ministers

15. Shareholding Ministers directly holding KGH shares would allow direct Ministerial influence over KGH and would mitigate the cost and timing implications of establishing a new entity.

16. However, it is uncommon for Ministers to hold shares in a company without it being subject to a legislative framework. Treasury considers it would be more appropriate for such a significant Crown-controlled entity to have an ownership structure with reporting and accountability obligations akin to those under the PFA or the CEA.

17. There are few other examples of large companies in which Ministers hold a majority of shares without a legislative framework applying to the company (the main one being Air New Zealand Limited (Air NZ)). Air NZ's ownership arrangements have evolved historically rather than being an intentional structural choice. In addition, Air NZ is publicly listed, which makes it subject to listing requirements such as continuous disclosure that partially mitigate potential concerns about the lack of a legislative framework.

18. We consider that a direct Ministerial shareholding would be more difficult for the Crown to exit, compared to other options. For example, any subsequent sale [33], [37], [38] would expose shareholding Ministers and the Crown to representations and warranties given by the Ministers in the share sale documentation.

19. We have also considered the related option of shareholding Ministers directly holding KGH shares, but with KGH itself being listed as a PFA Schedule 4A company. While this would implement a legislative framework for the Crown's shareholding, the other downsides listed above would remain. [33], [36], [37]

[33], [37], [38]

Crown entity company or a PFA Schedule 4A company

20. These two institutional forms (Crown entities and PFA Schedule 4A companies) are proven and established mechanisms for the Government's commercial activities.

21. The two forms are similar in many respects. Crown entity companies and PFA Schedule 4A companies have their functions and objectives set out in their constitutions and Statements of Intent. Primary legislation (a time-consuming process) is not required to establish these entities; instead, the Order in Council process can be used. Shareholding Ministers make board appointments and can remove directors. Key ministerial powers to direct the board include those of a majority shareholder pursuant to the Companies Act 1993. The companies are required to engage with Ministers during the drafting stages of the Statement of Intent and Ministers can direct changes to that document.

22. One key difference between the two types of companies is that a PFA Schedule 4A company allows for minority (less than 50%) private shareholders, whereas a Crown entity company must be 100% Crown-owned. There are also differences in the entities' governance and accountability regimes.

23. [33], [36], [37]

24. We consider that the PFA Schedule 4A company regime would be more suitable here, and the governance and accountability regime applying to a Crown entity company would not be feasible or appropriate.

25. [36]

26.

27. [36]

28. Another advantage of the PFA Schedule 4A regime is increased flexibility for future ownership arrangements. The Crown may sell up to 49% of the shares in a PFA Schedule 4A company, but the Crown must own all of the shares in a Crown entity company so there is no scope for shared ownership. Also, a company may be removed from PFA Schedule 4A via an Order in Council (which would allow a sale of all its shares), whereas a Crown entity company is only able to be wound down at the end of its life.

Existing entity or new entity

29. We have considered whether any existing entities could serve as the Crown vehicle for holding KGH shares, instead of incorporating a new entity.

30. In terms of existing Crown entities and PFA schedule 4A companies, one benefit of establishing a new entity is to insulate it from potential claims against the existing entity. [33], [37]

31. The value of a majority shareholding in KGH will likely exceed $1 billion. An asset value of this size is sufficient to justify the cost of establishing and operating a new entity. We also consider it valuable for the KGH Crown vehicle to be a sole purpose company, focusing on KGH, with specialised board members having relevant banking and financial sector expertise. Existing Crown entities or PFA schedule 4A companies will not have board members with these necessary skills as they would have been selected for a different purpose.

Recommendation

32. Treasury considers that the optimum structure by which the Crown could hold KGH shares is through a new PFA schedule 4A company to be established for this purpose.

Timing implications

33. Our initial estimate is that establishment of a new PFA Schedule 4A company would take at least five months, **assuming**:

    a we are able to obtain a waiver of the usual 28-day rule before the Order in Council listing the company on PFA Schedule 4A takes effect (we consider there are good grounds), and

    b the new entity's establishment board comprises only an establishment chair and one director, selected without a full call for nominations and public process (with a fuller board to be appointed in due course), as discussed further below.

34. However, we consider that this would still permit the parties to reach agreement on a KGH share purchase in advance.

__KGH share purchase arrangements can still be finalised before 30 June__

35. We consider that this timing would still allow finalisation of KGH share purchase arrangements prior to 30 June. Shareholding Ministers can finalise the arrangements for the share purchase prior to the new company being established. The documentation can be drafted so that the other shareholders consent to the holding vehicle (in place of the Crown) purchasing the shares and acceding to the contracts. The settlement of the share purchase would then take place at a later date, once the PFA Schedule 4A company has been established.

__Transaction may be able to proceed immediately after incorporation (before PFA Schedule 4A listing is complete)__

36. In the event that the new PFA Schedule 4A company is still not in place by the time of settlement, an additional option is for the Crown vehicle company to undertake the share purchase transaction (that is, take ownership of KGH shares) after it has been incorporated, but before its listing on PFA Schedule 4A has been completed. The process to make the Crown vehicle into a PFA Schedule 4A would then proceed in parallel with settlement of the commercial transactions (so the KGH purchase might take place before the Order in Council listing the Crown vehicle on PFA Schedule 4A takes effect).

37. [36]

__Interim Ministerial ownership has a number of disadvantages__

38. We have also considered the option of KGH shares initially being acquired by Ministers, and then transferred to the new PFA Schedule 4 company upon its establishment. We consider that this option should not be necessary from a timing perspective (given the alternative options outlined above), and also has a number of disadvantages, including:

    a Interim arrangements would need to be put in place for the time in which shares were directly held by Ministers, including arrangements for Treasury to administer and operate the KGH shareholding on behalf of Ministers, and any interim funding arrangements and appropriations.

b We would need to work through the financial implications of Ministers holding shares temporarily and then selling to the entity. For example, especially if there is a reasonable period between settlement of the initial transaction and transfer of the shares into the new entity, any change in value may need to be reflected.

c We would also need to consider the structure of the transaction by which shares move from the Crown into the new entity. One option is for the Crown to capitalise the new entity so that it can purchase the shares from the Crown. An alternative is for the Crown to capitalise the new entity by transferring the shares into it. Each option will have accounting implications.

d Any remaining KGH shareholder/s would need to agree to structure the KGH share purchase in this manner. This adds an additional uncertainty in the process. In this regard, we understand that NZSF is focused on ensuring that KGH's governance arrangements allow for the bank to be a robust commercial competitor in a dynamic marketplace, and that the nature of Government expectations is clearly expressed and transparent (as would be the case through shareholding Ministers' letters of expectations to the PFA Schedule 4A Crown vehicle).

39. However, this option remains available as a backstop (albeit with disadvantages), and we propose to further progress this option in parallel so that it is available in the event that establishment of the Crown vehicle would otherwise hold up the share purchase transaction (for example, by ensuring share purchase documentation is sufficiently flexible to permit this).

Consultation

40. Treasury has approached PSC in respect of the recommendations in this paper from a machinery of government perspective. PSC's view is that the establishment of a commercially-focused PFA Schedule 4A company is largely a matter for Treasury officials to advise on. Treasury and PSC will continue to engage on this matter.

41. As you are aware, the project team structure includes a Steering Group (inclusive of external expert advisors), with which we test key aspects of the project's workstreams and advice. This report was completed following consultation with the project Steering Group on the direction of this advice and the recommendations.

Next Steps

42. If Ministers agree in principle to establish a new PFA Schedule 4A company for the purpose of holding KGH shares, we will provide further advice for your consideration, on matters such as the Crown vehicle nature, purpose and functions, constitution, letter of expectations and funding arrangements.

43. We also propose to commence the search for directors immediately once Ministers agree in principle to establish the Crown vehicle. In this regard, we recommend that the new entity's establishment board comprise only an establishment chair and one director, selected without a full call for nominations and public process. Appointing the chair of the new board will provide leadership for the establishment of the Crown vehicle and act as a drawcard to candidates for other roles on the board. The additional director can also work with the new chair on establishment matters.

44. A search for an establishment chair and one director without a full call for nomination and public process will take around 3-4 months. We recommend that the process of identifying suitable directors commences now as this will allow for a quicker establishment process following the Cabinet decision on the establishment of the Crown vehicle. If you agree, we will provide advice seeking your further instructions on the board search process, including skills and capability profiling, candidate identification, short-listing, due diligence and interview panel composition, fees, and appointment terms and tenure.

45. The remaining board members can then be selected through a public call for nominations and appointed at a later date (if necessary, after completion of the KGH share purchase).

46. Cabinet would also need to approve the establishment of this new entity. Our initial thinking is that this approval (and any associated appropriations for establishment/operating costs) could be sought at the same time as any appropriations for the KGH share purchase, after the Budget Moratorium.