

# The Treasury

## Project Korimako - Release of advice

December 2022

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- [23] 9(2)(a) - to protect the privacy of natural persons, including deceased people
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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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## Treasury Report: Project Korimako - May Update

<b>Date:</b>	1 June 2022	<b>Report No:</b>	T2022/1187
		<b>File Number:</b>	SE-1-3-22

### Action sought

	Action sought	Deadline
<b>Minister of Finance</b> (Hon Grant Robertson)	<p><b>Provide</b> feedback on the draft Cabinet paper</p> <p><b>Consult</b> your Cabinet colleagues on the draft Cabinet paper</p> <p><b>Agree</b> that the net cost of the Korimako transaction count against the multi-year capital allowance</p>	8 June 2022
<b>Associate Minister of Finance</b> (Hon David Parker)	<b>Provide</b> feedback on the draft Cabinet paper	8 June 2022

### Contact for telephone discussion (if required)

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

### Minister's Office actions (if required)

<b>Return</b> the signed report to Treasury.
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Note any feedback on the quality of the report

**Enclosure:** Yes Project Korimako Cabinet Paper - Further Developments with Kiwi Group Holdings (Kiwibank) (Treasury:4647140v3)

# Treasury Report: Project Korimako - May Update

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## Executive Summary

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This report is your May update on Project Korimako. In addition, a draft Cabinet paper is attached for your consideration that seeks appropriations to fund the purchase of KGH shares and agreement to the establishment of the company to hold the Crown's investment in Kiwi Group Holdings Limited (KGH) shares.

### ***Planning for the transaction has progressed across all workstreams but there have been delays in commencing due diligence***

We are working with KGH shareholders and the KGH board to define the approach to due diligence. We will be reporting to you in a couple of weeks on the timeframe for the transaction once we have commenced due diligence and have more certainty around how the work is progressing. We are progressing matters such as the preparation of the Sale and Purchase Agreement in parallel to minimise any delays.

[33], [37], [38]

We have continued working on the establishment of the Crown holding company with approval to establish and fund the company in the attached draft Cabinet paper. Once we have a nominated participant from Kiwibank Limited (Kiwibank), we intend to meet with the Reserve Bank of New Zealand (RBNZ) to establish whether there are any regulatory requirements associated with the Korimako transaction.

### ***The attached draft Cabinet paper seeks the appropriations for the transaction and approval to establish the Crown holding company***

Attached for your consideration is a draft Cabinet paper for you to use to consult your Cabinet colleagues. In addition to updating Cabinet on Project Korimako, the Cabinet paper seeks:

- an appropriation of [25], [37], [38] to fund the purchase of KGH shares
- an increased appropriation for Treasury's commercial monitoring function of \$600,000 for 2022/23 and \$350,000 for 2023/24 onwards
- approval to establish a 100% Crown owned company to be listed in Schedule 4A of the Public Finance Act 1989 to hold any KGH shares purchased by the Crown
- delegated authority for shareholding Ministers to take all decisions and actions necessary to incorporate the Crown holding company and facilitate its establishment, and
- delegated authority for the Minister of Finance and the Associate Minister of Finance (Hon David Parker) to take any necessary actions, including establishing new appropriations as required, to complete the purchase of KGH shares if incorporation of the Company is delayed.

### ***The cost of purchasing KGH shares will be partially offset by a special dividend from NZ Post and we propose the net cost counts against the multi-year capital allowance***

An appropriation for share purchases of [25], [37], [38] is recommended. This amount is sufficient to fund the purchase of 100% of KGH. The size of both the sale price and special

dividend are still uncertain but for illustrative purposes, allowing for the expected special dividend from NZ Post of the majority of its sales proceeds from the sale of KGH shares, the net impact would be approximately [25]

You have three options for counting the transaction against the multi-year capital allowance: counting the gross impact [25], [37], [38] counting the net impact [25] or excluding the transaction from counting against the allowance. We recommend counting the net impact, and the Cabinet paper is written on this basis, although square bracketed pending your decision, as this option best reflects the cost of the transaction as a whole and is most consistent with the policy intent of the Fiscal Management Approach.

***Increased monitoring funding for the Treasury is proposed to fund the specialised monitoring required for a regulated bank***

Treasury will be required to undertake performance monitoring activity and provide timely and effective performance and ownership advice. This work will be done within the context of an entity subject to a significant financial regulatory framework through the RBNZ and a continuous disclosure regime administered by the NZX. There will be aspects of the monitoring role that will be unique to this entity compared to other entities in the Crown's commercial portfolio.

The proposed funding would provide for specialist external expertise in the first year to establish the monitoring and policy framework to be applied. It would also support two full time equivalent personnel to cover monitoring, increased governance and appointments activity, [33], [37], [38] Periodic Strategic Reviews would also be funded.

## Recommended Action

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We recommend that you

- a. **provide** feedback on the draft Cabinet paper
- b. **consult** your Cabinet colleagues on the draft Cabinet paper, and

EITHER

- c. **agree** that the gross cost of the Korimako transaction [25], [37], [38] count against the multi-year capital allowance.

Agree / Disagree  
Minister of Finance

OR (Treasury Recommendation)

- d. **agree** that the net cost of the Korimako transaction including the NZ Post special dividend [25] count against the multi-year capital allowance.

Agree / Disagree  
Minister of Finance

OR

- e. **agree** that the cost of the Korimako transaction should not count against the multi-year capital allowance.

Agree / Disagree  
Minister of Finance

Shelley Hollingsworth  
**Manager, Commercial and Institutional Performance**

Hon Grant Robertson  
**Minister of Finance**

Hon David Parker  
**Associate Minister of Finance**

## Treasury Report: Project Korimako - May Update

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### Purpose of Report

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1. This report is your May update on Project Korimako. It provides a summary of progress made with the project covering negotiations, due diligence, [33], [37], [38] and establishing a Crown holding vehicle. A draft Cabinet paper is attached for your consideration that seeks appropriations to fund the purchase of KGH shares and agreement to the establishment of the company to hold the Crown's investment in KGH shares.

### Summary of Progress During May

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#### ***Negotiations and Due Diligence***

2. A two-phase approach to discussions was agreed with KGH shareholders whereby more intensive work would commence once exploratory discussions confirmed that there is a reasonable basis to move forward with a transaction. As previously advised, all KGH shareholders agreed to move to the second phase of the process including due diligence.
3. We are working with KGH shareholders and the KGH board to define the approach to due diligence. We are conscious of the distraction risk of a due diligence exercise given capacity constraints within KGH and Kiwibank. We are seeking meetings with select executives only in order to identify readily accessible resources as a pragmatic means of moving forward at pace.
4. A dataroom is being established that will hold the information provided by KGH and Kiwibank for due diligence. Ernst & Young is scheduled to commence due diligence around mid-June.
5. There are likely to be implications for the planned negotiations timeframe due to some delays in the commencement of due diligence. We will be reporting to you in a couple of weeks on the timeframe for the transaction once we have commenced due diligence and have more certainty around how the work is progressing. We are progressing matters such as the preparation of the Sale and Purchase Agreement in parallel to ensure that we are ready to move as soon as due diligence progresses.

[33], [37], [38]

6. [33], [37], [38]

#### ***Crown Holding Vehicle***

7. You have agreed to the establishment of a Public Finance Act 1989 (PFA) Schedule 4A company (the Company) and its design features, such as the constitution, financial restrictions, and Ministerial shareholders (T2022/707 and T2022/934 refers). You have

also agreed to the process for selecting directors for the Company, initially focused on an establishment director (T2022/924 refers).

8. We have continued working on the establishment of the Company. We have reported to you with a shortlist of proposed directors for the Company (T2022/1122 refers). We are liaising with the Cabinet Office regarding the allocation of Ministerial responsibilities to avoid the potential for conflicts of interest between Ministers making decisions on the sell-side and buy-side of the KGH share transaction.
9. [36]
10. Our previous papers discuss the option of Ministers (on behalf of the Crown) undertaking the initial purchase of KGH shares, with KGH shares later transferred from the Ministers to the Company once established (T2022/707 and T2022/934 refers). This would be a fallback bridging option that would only be triggered if there was a lengthy delay in the incorporation of the Company. This two-stage process will involve a range of additional considerations that we are working through, including:
  - a Shareholding Ministers may need to appoint directors to the boards of each of KGH and Kiwibank following settlement, if any of the existing board (particularly those appointed by current KGH shareholders) step down upon settlement of the KGH share purchase. We are currently exploring governance options at the KGH/Kiwibank level.
  - b There would be additional, and more complex, financial implications (e.g. in the event of a change in value in the interim period) and transactional structuring / documentation.
  - c 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.
  - d If the Crown purchased less than 100% of KGH shares, any remaining KGH shareholder/s would need to agree to structure the KGH share purchase in this manner (as the provisions of the Crown Deed will apply).
  - e A direct Ministerial purchase may prompt an expectation or concern amongst key stakeholders of KGH/Kiwibank (lenders to Kiwibank, customers, staff, leadership, board members and the general public) of political intervention into the bank's commercial mandate, strategic direction and/or operational decisions. As KGH shareholders, shareholding Ministers may also come under greater pressure whether or not to contribute capital to KGH/Kiwibank than would be the case if the KGH shares were held by the Company.
  - f In the event that, after signing the Sale and Purchase Agreement, Reserve Bank of New Zealand (RBNZ) approval is a pre-condition to the transfer to the new holding company (discussed further below), a delay in incorporating the company could in turn delay this approval.
  - g [33], [37], [38]

11. In light of the above, we consider that it is important to continue prioritising the appointment of Company directors and the incorporation of the Company (particularly given the possible timing impact of Parliamentary recesses) so as to avoid the complexity of the two-stage process.

### **Regulatory**

12. Initial scoping work has been undertaken on the regulatory implications of the proposed purchase of the KGH shares. At this stage it is unclear whether the Crown purchase of shares and the creation of a new holding company will trigger the need for a formal approval from the Reserve Bank of New Zealand (RBNZ). If required, the approval process would be expected to take 3 to 5 months after signing the sale and purchase agreement. We have sought authorisation from KGH and its shareholders to engage with the appropriate Kiwibank executives to enable a joint engagement with the RBNZ. We are prepared to engage with the RBNZ as soon as we have a Kiwibank executive to participate and would not expect the discussion process with the RBNZ to take a long time.

### **Draft Cabinet Paper**

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13. Attached for your consideration is a draft Cabinet paper for you to use to consult your Cabinet colleagues. It is intended to submit the Cabinet paper to the Cabinet Economic Development Committee (DEV) on 29 June 2022.
14. The draft Cabinet paper:
  - updates Cabinet on the Crown's purchase of shares in KGH
  - seeks an appropriation to fund KGH share purchases, and
  - seeks approval for the establishment of a PFA Schedule 4A company to hold the Crown's KGH shares.

### **Capital Appropriation**

15. An appropriation for share purchases of [25], [37], [38] is recommended. This amount is sufficient to fund the purchase of 100% of KGH. If a lower level of ownership is achieved the cost would be lower. Allowing for the expected special dividend from NZ Post of the majority of its sales proceeds from the sale of KGH shares, the net impact would be approximately [25]

16. [25]

- 17.

18. The Treasury has approached the special dividend matter from a perspective of an optimal capital structure, [25]

However, further time is required to understand how certain matters will materialise. We will recommend this work continue to be advanced [25]

19. The Cabinet paper is structured to allow for two alternative measures of settling KGH purchases. It is likely Ministers will enter into the sale and purchase agreement and the new Company to be established will purchase the shares on settlement. This arrangement is reflected in the funding appropriation where the Crown subscribes for shares in the new Company as the means of funding the purchase of KGH shares.
20. If, however, the new Company cannot be incorporated within a reasonable timeframe, Ministers would purchase the shares directly and transfer the shares to the new Company following its incorporation. In this unlikely scenario, we would endeavour to design the transaction so as to have minimal impacts with Ministers holding the shares as a bridging arrangement until the Company is incorporated. Delegated authority to amend appropriations to reflect these potential alternative arrangements is sought.
21. As the Company will primarily act in a holding capacity, its direct operational expenses should be limited. It will, however, have expenses such as Board fees and costs associated with legal matters, accounting and financial reporting. The Cabinet paper proposes that shareholding Ministers provide the Company with an initial level of working capital as part of their delegated authority to oversee the establishment of the Company. This funding can be incorporated within the appropriation to fund KGH share purchases as the appropriation relates to the capitalisation of the new Company. We have indicated that initial working capital of [33] would be sufficient. This amount has been calculated by estimating the likely operating expenses of the Company, including the need for any one-off establishment costs in the first year, and the timing of any income to the Company from its investment in KGH. We have benchmarked our forecast expenses for the Company against the experience of other PFA Schedule 4A companies such as Crown Regional Holdings Limited and New Zealand Green Investment Finance Limited.

### ***Fiscal Management treatment***

22. The Fiscal Management Approach (FMA) is a set of rules that help the Government achieve its fiscal strategy. Over the last couple of decades, the FMA has been instrumental in helping the Government meet its fiscal strategy. The starting presumption with the FMA is that all items with fiscal implications should be managed within Budget allowances. This approach:
  - *ensures Government decisions are consistent with the fiscal strategy* – the allowances are set by Ministers in accordance with the fiscal strategy and forms a self-imposed cap on expenditure growth
  - *incentivises prioritisation of new spending* – working within allowances encourages Ministers to trade-off the relative priorities of new spending when forming a package of high-value initiatives, and
  - *provides transparency of the Government's spending* – the allowances convey to the public and other stakeholders how much the Government intends to spend over the forecast period.
23. However, there is flexibility to apply judgement in exceptional circumstances to help avoid pro-cyclical fiscal policy and manage volatility. For this transaction, we have identified three options for Ministers to consider in applying the FMA:
  - ***Option 1*** – this option charges the gross new capital expenditure appropriation [25], [37], [38] against the multi-year capital allowance. This option would reduce

the funding remaining in the multi-year capital allowance to [25], [33], [37], [38] for the next three budgets. It is not preferred as it does not take into account the partial offset from the special dividend being paid by NZ Post.

- **Option 2 (recommended and currently included in the draft Cabinet paper)** – reflecting the special dividend that NZ Post will pay to the Crown as part of this transaction, this option charges the net debt impact [25] against the multi-year capital allowance. This option is preferred as it reflects the direct net debt impact of the transaction. This option would reduce the funding remaining in the multi-year capital allowance to [25], [33], [37], [38] for the next three budgets.
- **Option 3** – this option manages the costs of the transaction outside of budget allowances. This option is not preferred as it would entail a significant negative impact on the net debt position, with the capital expenditure not being managed through the budget allowances.

24. While both Option 1 and Option 2 reduce the funding remaining in the multi-year capital allowance, you will have the opportunity to revisit the allowance settings as part of the development of the 2022 Half Year Update and 2023 Budget Policy Statement later this year.

### ***Increased Monitoring Activity for Treasury***

25. On completion of Project Korimako, it is expected that the Crown will directly (through the Company) hold at least a majority and potentially 100% of KGH – a company which, in turn, will own all of New Zealand’s fifth largest registered bank. Ministers will then have the ownership responsibilities and levers that come with direct ownership.
26. To support Ministers in undertaking this new role, the Treasury will be expected to undertake performance monitoring activity and provide timely and effective performance and ownership advice to Ministers including how they can most effectively use their ownership levers. New and ongoing activities will include:
- appointing the board of the Company and, through this vehicle, facilitating strong governance for KGH and Kiwibank (and other operating subsidiaries)
  - setting the ownership objectives for the group
  - approving annual accountability documents and ensuring alignment of strategy and performance measurement
  - holding the board to account for the performance of the underlying subsidiaries including Kiwibank
  - considering and approving significant investments and transactions
  - engaging with any other shareholders of KGH on behalf of the Crown
  - responding to and assessing future requests for capital by the entity, whether due to regulatory requirements or to support business (and owner’s) objectives.
27. This work will be done within the context of an entity subject to a significant financial regulatory framework through the RBNZ and a continuous disclosure regime administered by the NZX. This will be the first time that the Crown has directly owned a regulated retail bank in more than two decades and there will be aspects of the monitoring role that will be unique to this entity compared to other entities in the Crown’s commercial portfolio.

28. [33], [37], [38]

29. We have proposed an increased appropriation for Treasury's commercial monitoring function of \$600,000 for 2022/23 and \$350,000 for 2023/24 onwards. This funding would provide for specialist external expertise in the first year to establish the monitoring and policy framework to be applied. It would also support two full time equivalent personnel to cover monitoring, increased governance and appointments activity, [33], [37], [38] It would also provide consultancy funding from time to time to undertake Strategic Reviews.

### ***Company Name***

30. The Cabinet paper notes that the proposed name for the PFA Schedule 4A company is Kiwi Group Capital Limited. You can choose a different name if you prefer but the words "bank", "banker", and "banking" cannot be used because the Company will not itself be a registered bank.

### **Next Steps**

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31. Planned activity in June includes commencing due diligence, [33], [37], [38] identification of board members for the Crown vehicle, and negotiating agreements with KGH shareholders. Communications messages will also be developed for announcement at the point that agreements with KGH shareholders are reached.

[36]

[36]