

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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Treasury Report: Project Korimako - June Update

Date:	6 July 2022	Report No:	T2022/1404
		File Number:	SE-1-3-22-2

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree that director renewals for KGH companies should continue as usual ahead of the Project Korimako transaction	13 July 2022
Associate Minister of Finance (Hon David Parker)	Agree that the Crown supports the KGH Chair continuing in this role for at least a transitional period following the Korimako transaction Agree to the recommended approach to shareholder decisions (including director appointments) for KGC and its subsidiaries	

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)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: Appendix: Project Korimako – Target timetable

Treasury Report: Project Korimako - June Update

Executive Summary

This report is your June update on the progress of Project Korimako.

In addition, your approval is sought to the approach to shareholder decision making (including director appointments) for Kiwi Group Capital Limited (KGC) and its subsidiary companies.

The Project is tracking in line with the critical path illustrated in the target timetable provided on 10 June 2022 (T2022/1301 refers) with a signed document scheduled for 2 August

Significant progress was made during June including the commencement of due diligence.

- The due diligence process is on track. Financial and legal due diligence interim reports were received on 30 June 2022 as scheduled. [25]

- The draft Sale and Purchase Agreement (SPA) and waiver of the Crown Deed (Waiver) have been provided to each of the Kiwi Group Holdings Limited (KGH) shareholders. [33], [37], [38]

- Meetings commenced with the Reserve Bank of New Zealand (RBNZ) to facilitate RBNZ's regulatory approval of the transaction. We are working with Kiwibank to frame a work programme and to compile the detailed material the RBNZ requires for its assessment.
- The Cabinet paper seeking agreement to the establishment of the Crown holding vehicle (KGC) and appropriations to fund share purchases was considered by the Economic Development Committee meeting on 29 June and by Cabinet on 4 July.
- We have provided you with a shortlist of proposed directors for KGC (T2022/1122 refers). Once we receive Ministers' response to the shortlist report we will be in a position to contact the director candidates and continue with the establishment of KGC.
- [26]

We note, however, that the terms of three Kiwibank directors come up for renewal this calendar year. From a continuity perspective, we consider that it would be beneficial for KGH to continue to follow its usual process and work with the Kiwibank Chair to extend these directors' terms ahead of the Korimako transaction. In addition, we consider it would be helpful to the overall process if we were able to indicate to the KGH Chair that the Crown would support the KGH Chair continuing in this role for at least a transitional period following the Korimako transaction.

- A communications network comprising the Treasury, KGH, KGH shareholders, Kiwibank, and The New Zealand Home Loan Company Limited (NZHL) has been established. Work is underway to develop a communications approach to support the announcement of a KGH transaction following the signing of the SPA. We are consulting with your office and will provide written advice on the communications approach during July.
- [33], [37], [38]

Director Appointments and other Shareholder Decisions for KGC and Subsidiaries

We are seeking your agreement to the process to be adopted for shareholder decision making arrangements post the Korimako transaction (including director appointments) for KGC and its subsidiary companies. This decision is needed now as it will be a key input in our upcoming discussions with the RBNZ regarding its decision as to whether to consent to the change in Kiwibank's ultimate ownership and our ongoing work with the KGH and Kiwibank boards regarding managing transitional governance and implementing new arrangements post-share transfer.

We have considered the approach to director appointments and other shareholder decisions for KGC and its subsidiaries with respect to the Government's stated goals. In particular, [25] to ensure Kiwibank can remain New Zealand owned and majority Crown-owned, be a disruptor bank, act commercially, and be a genuine competitor in the banking industry.

If any of the existing KGH shareholders choose not to exit at this time, then the current requirements of the KGH Shareholders' Agreement will remain in force, including those governing shareholder decisions and the appointment of directors. If the Crown acquires 100% of KGH, however, we propose that for KGC and its subsidiaries, consistent with the default position under the Companies Act 1993, each group company, as shareholder, makes shareholder decisions in respect of its direct subsidiary, including appointing the directors of its direct subsidiary. Ministers would make shareholder decisions in respect of KGC and appoint directors to KGC's board, with each company then making shareholder decisions and appointing board members to its subsidiary companies.

We recommend this approach because it would enable Ministers to exercise appropriate control over the Crown's ownership of the KGC group as a whole, while still being likely to attract high calibre commercially experienced director candidates for the Kiwibank board and supporting Kiwibank to be perceived by its stakeholders (directors, employees, customers and others) to operate commercially.

[25]

Recommended Action

We recommend that you:

- a **agree** that prior to the Korimako transaction being completed KGH should continue to follow its usual process and work with the Kiwibank Chair to extend the terms of those Kiwibank directors coming up for renewal this calendar year

Agree/disagree.
Minister of Finance

Agree/disagree.
Associate Minister of Finance

- b **agree** that the Crown supports the KGH Chair continuing in this role for at least a transitional period following the Korimako transaction

Agree/disagree.
Minister of Finance

Agree/disagree.
Associate Minister of Finance

- c **agree** that post the Korimako transaction, for KGC and its subsidiaries, consistent with the default approach under the Companies Act 1993, each group company, as shareholder, makes shareholder decisions in respect of its direct subsidiary, including appointing the directors of its direct subsidiary.

Agree/disagree.
Minister of Finance

Agree/disagree.
Associate 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 - June Update

Purpose of Report

1. This report is your June update on Project Korimako. It provides a summary of progress made with the project covering due diligence, transaction documentation, approval processes, communications, [33], [37], [38]
2. The report also seeks your agreement to the process to be adopted for shareholder decision making (including director appointments) for Kiwi Group Capital Limited (KGC) and its subsidiary companies.

Summary of Progress During June

3. Appended to this report is the project timetable provided earlier (T2022/1301 refers). We reference this timetable when discussing the status of each workstream.

Due Diligence (on track for completion by 21 July as scheduled)

4. The due diligence process is on track. On Monday 20 June, the dataroom opened and now contains Board papers and financial and tax information from Kiwi Group Holdings Limited (KGH), The New Zealand Home Loan Company Limited (NZHL), and Kiwibank Limited (Kiwibank).
5. Financial and legal due diligence interim reports were received on 30 June 2022 as scheduled. [25]
6. We will be planning the best strategy for follow-up questions and management sessions. We are meeting with EY and Minter Ellison twice a week to receive updates on their findings throughout the due diligence process. EY and Minter Ellison will present an initial draft of their report by 15 July and provide final reports on 21 July as scheduled.

Transaction Documentation (scheduled completion continues to be 2 August although we note achieving this date is dependent on the responses of the KGH shareholders)

7. The focus of the negotiations workstream has been on the development of the Sale and Purchase Agreement (SPA) [33], [37], [38]
8. [33], [37], [38]

9. In terms of the SPA negotiations, we began engaging with ACC, NZ Post and NZSF in the week beginning 27 June. We will be seeking to expedite this process, bearing in mind the interdependencies between the negotiations and the due diligence process. Our project timetable targets completion of negotiations on the SPA for 22 July in line with the completion of due diligence. We will have a better understanding of the implications of the SPA negotiations for the project timeline following the next iteration of the document with KGH shareholders over the next week.

Approval Processes

Regulatory approvals (not identified in the earlier project timeline but not expected to lead to project delays)

10. We have held a joint Treasury and Kiwibank meeting with the Reserve Bank of New Zealand (RBNZ). We provided an overview of the proposed transaction and sought working level engagement with the RBNZ.
11. RBNZ advised that their normal approval processes for applications of this nature could take up to 3 months to complete. However, they acknowledged that with the Crown continuing to be the ultimate shareholder, albeit through different ownership vehicles, RBNZ's key areas of consideration (prudential soundness, strength of shareholder capital, and quality of governance and bank independence) should continue to be met. As a result, we expect that their process could be completed well within their indicative period.
12. The next step is the establishment of a joint team and beginning working level engagement with the RBNZ to help frame out the work programme and complete the detailed material required for the approval application.

Cabinet approvals (achieved)

13. The Cabinet paper seeking agreement to the establishment of the Crown vehicle and appropriations to fund share purchases was considered by the Economic Development Committee meeting on 29 June and by Cabinet on 4 July. Transfers of Ministerial responsibilities for the new company (to avoid the potential for conflicts of interest) are now in place.

Director appointments (delayed)

14. We have reported to you with a shortlist of proposed KGC directors (T2022/1122 refers). KGC's establishment will not meet the scheduled completion date of 16 August due to the delays in identifying director candidates. Once we receive Ministers' response to the shortlist report, we will contact the director candidates and continue with KGC's establishment, with the aim of incorporating KGC prior to completion of the KGH share transfer.
15. ^[26]

16. As a result of the Korimako transaction, the existing KGH directors (all of whom were nominated by KGH shareholders) would ordinarily be expected to resign. We consider it would be helpful to the overall process in relation to KGH and Kiwibank governance if we were able to indicate to the KGH Chair that the Crown supports the KGH Chair continuing in this role for at least a transitional period following the Korimako transaction.
17. We are also obtaining feedback from the KGH and Kiwibank Chairs on director appointment and governance matters generally, to inform our recommendations to Ministers regarding future governance arrangements.
18. Separately discussed below, we are seeking Ministers' agreement to the process to be adopted for the post-transaction shareholder decision making arrangements (including director appointments) for KGC and its subsidiary companies.

Communications (planning is on track for an announcement date of 2 August)

19. We have established a communications network comprising the Treasury, KGH, KGH shareholders, Kiwibank, and NZHL. The group has agreed to collaborate to ensure that all communications are aligned and coordinated, with the Treasury providing the central coordinating function. The group meets weekly and has established protocols to ensure that the group can collaborate quickly to respond to any communication requirement that arises.
20. Work is underway to develop a communications approach to support the announcement of a KGH transaction, with the communications network members providing their proposed key messages and approach for communicating with each of their key audiences, including Kiwibank staff and customers.
21. We are consulting with your office and will provide written advice on the communications approach during July.

[33], [37], [38]

22. [33], [37], [38]

Shareholder Decisions and Director Appointments for KGC and Subsidiaries

23. We are seeking your agreement to the process to be adopted for shareholder decision making arrangements post the Korimako transaction (including director appointments) for Kiwi Group Capital Limited (KGC) and its subsidiary companies. It is important to make this decision now as it will be a key input in our upcoming discussions with the RBNZ regarding its decision as to whether to consent to the change in Kiwibank's ultimate ownership. It is also a necessary component of our ongoing work with the KGH and Kiwibank boards regarding governance arrangements, including managing transitional governance and implementing new arrangements post-share transfer. In particular, timely communication to the KGH and Kiwibank boards of an arms' length governance approach will mitigate stakeholder concerns as to retention of key staff.
24. Ministers have previously indicated a desire to have some level of Government influence as to the objectives of Kiwibank and, in particular, for Kiwibank:
 - a to remain New Zealand owned and majority Crown-owned,
 - b to be a disruptor bank,

- c to act commercially, and
 - d to be a genuine competitor in the banking industry.
25. The main issue in this context is how much influence it is desirable for shareholding Ministers (and their advisers) to have, or to be seen to have, over Kiwibank (and other commercial businesses in the group). [25]

if there is a perception

by Kiwibank stakeholders (such as its staff, leadership and/or the regulator) that the bank might not operate in a commercial manner at arms' length from Ministers, this could serve to compromise the achievement of those strategic objectives.

26. This compromise could manifest itself in multiple ways, including:
- a People: A perception that the business may not act entirely commercially would work against the ability of Kiwibank to attract and retain high-quality board members and senior executives. [26], [33], [37]
 - b Equity investors: A perception that the bank might not operate on an arms' length commercial basis also works against a fully commercial relationship [33], [37], [38]
 - or a future strategic investor that could bring added value to Kiwibank. It reduces the value of the business to investors and the Crown by reducing expectations of future commercial success.
 - c Financing: While the Crown may hold a controlling interest in Kiwibank through ownership of its equity share capital (via the KGC group), most of Kiwibank's financing comes from other sources (\$31 billion of total assets are financed by \$29 billion of liabilities, primarily bank deposits and debt securities).¹ A perception that the bank might not operate on an arms' length basis may reduce some investors' willingness to place their funds with the business, albeit recognising that some investors would consider that the business will be supported by the Crown in the event of distress.
 - d Customers and the community: A perception that the bank is not operated on an arms' length basis may also nurture an expectation that Ministers (or their appointed directors) can be prevailed upon to intervene when some bank customers (or other members of the community) seek non-commercial concessions, or do not agree with business decisions that Kiwibank has made, albeit on a commercial basis and in line with Ministers' strategic objectives. Arm's length governance arrangements also protect Ministers' interests by making clear that company management is responsible for operational matters.
 - e The regulator. The closely regulated context of banking makes Kiwibank somewhat unique relative to other Crown investments. We expect the RBNZ, Kiwibank's main regulator, to focus closely on the degree of Ministers' direct involvement. This will be relevant for:
 - their decision as to whether to consent to the change in the Crown and KGC's significant influence over Kiwibank (which is expected to be a condition to completion of the KGH share transfer); and
 - their ongoing regulation of Kiwibank.

¹ [Disclosure Statement December 2021 \(kiwibank.co.nz\)](https://www.kiwibank.co.nz/disclosure-statement-december-2021)

27. The RBNZ's approach is that corporate governance practices in banks need to take account of wider financial stability considerations (not just the interests of the bank's shareholders). It will need to be satisfied that there is an appropriate degree of separation between the bank and its owners, both on initial registration and on a continuing basis.² In particular, the implementation of arm's length governance arrangements and the appointment of appropriately qualified and overtly independent directors are expected to be key points of focus for the regulator. Straightforward and clearly arm's length governance arrangements are expected to facilitate the RBNZ's process of consideration and approval of the transaction, as well as its ongoing Kiwibank supervisory role.
28. A corollary of the RBNZ's regulatory role is that it provides a level of scrutiny that may lessen the need for direct Ministerial involvement. For example, no director or Chair of a bank can be appointed unless the RBNZ has advised that it has no objection to that appointment.

Director Appointments

29. The context outlined above highlights the importance of getting the right balance of Ministerial involvement in director selection and appointment throughout the group of companies. The holding company structure in which the Crown will hold its ultimate interest in Kiwibank comprises three tiers of governance for which there are different appointment objectives: KGC, KGH and Kiwibank (along with other KGH subsidiaries). The appointment objectives set out below reflect the factors discussed above.
- a KGC directors represent the Crown's interests in respect of KGH. The key objective of the KGC director appointment process will be to attract directors in whom Ministers have confidence and who understand the Crown's strategic objectives for the KGH group.
- b KGH directors will be focussed on representing, and [33], [37], [38] balancing, the interests of KGH's shareholders in respect of Kiwibank and the other businesses owned by KGH. [33], [37], [38]
- c Kiwibank directors must be high calibre commercially experienced candidates [25]
- The Kiwibank director
- appointment process should:
- i be substantively comparable to the director appointment process for other New Zealand banks
 - ii minimise any perceptions that the bank might not operate on an arms' length basis and maintain confidence that Kiwibank is a commercially focussed bank
 - iii involve a streamlined process that omits any unnecessary steps or approvals, and be capable of resulting in a quick appointment decision (for example, where necessary to fill gaps on the board), and
 - iv comprise high quality decision making that focusses on Kiwibank's needs and the candidates who would best support Kiwibank achieving its disruptor and commercial objectives.

² [BS14: Corporate Governance, RBNZ](#)

Approach to director appointments

30. Given the context for director appointments outlined above, we consider the best approach to director appointments for KGC and its subsidiaries is to apply the default position under the Companies Act 1993. Each group company, as shareholder, makes shareholder decisions in respect of its direct subsidiary, including appointing the directors of its direct subsidiary. Ministers would make shareholder decisions in respect of KGC and appoint directors to KGC's board, with each company then making shareholder decisions and appointing board members to its subsidiary companies.
 31. This approach is consistent with the increasing benefit of a reducing perception of operating outside an arms' length commercial basis as one moves down the group company structure, and it aligns with how the appointment objectives outlined above change from one level to another in the group. While for other Crown investments (like Air New Zealand and the Mixed Ownership Model companies) Ministers are shareholders in the key operational entity, given the unique regulated banking context the KGC group structure can be used to our advantage in ensuring Kiwibank (as the key operational entity) operates on an arms' length commercial basis.
 32. If the Crown vehicle was not yet in place at the settlement of the purchase of KGH, and Ministers directly held shares in KGH, their role under this approach would be limited to appointment of new KGH directors for that interim period.
 33. We recommend this approach because it would enable Ministers to exercise appropriate control over the Crown's ownership of the KGC group as a whole, while still being likely to attract high calibre commercially experienced director candidates for the Kiwibank board and supporting Kiwibank to be perceived by its stakeholders (directors, employees, customers and others) to operate commercially. The level of influence under our proposed approach is an increase to the level of Ministerial influence on Kiwibank under the current arrangements with fully independent shareholders such as NZSF and ACC.
 34. We have considered some options for Ministers having more engagement in the subsidiary company director appointments, such as:
 - a Ministers sharing their expectations around the calibre and capabilities of subsidiary directors through the usual letter of expectation process to the KGC board and through their engagement with the KGC board. For example, the letter of expectations could share Ministers' views on the matrix of required skills and appointment criteria for directors, and
 - b the selection of Kiwibank's Chair (from among the pool of existing independent directors appointed by KGH) being subject to the Minister of Finance's approval. This is similar to the practice for Air New Zealand Limited and for Mixed Ownership Model companies [25] and [26]
- However, with a sole Crown shareholder, this would be more of a symbolic right that is likely to increase the appearance that the bank is not operating on an arms' length commercial basis, especially as it would be in addition to the RBNZ's approval role. We recommend against adopting this option.
35. If KGC was not the 100% shareholder of KGH, options like these might have additional complexity if other shareholders also expected to have the same rights.
 36. [25] and [26]

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

Other shareholder decision making rights

38. The current shareholders of KGH have a Shareholders' Agreement that provides for a range of shareholder rights. Its main purpose is to balance the power amongst the shareholders. If the Crown acquires 100% of KGH the existing Shareholders' Agreement will fall away. Each shareholder in the KGC group would then have the shareholder rights prescribed under the Companies Act 1993 in respect of its direct subsidiary. We are considering whether any other matters of the businesses of KGH or Kiwibank should be reserved for shareholder approval (beyond the Companies Act 1993 requirements). In any event, consistent with the above approach to director appointments, we consider that any shareholder decisions should be made by the immediate parent company. [33], [37], [38]

Ministers' Strategic Objectives

39. We consider that this approach to director appointment and other shareholder decision-making will still enable shareholding Ministers to clearly communicate their strategic objectives for Kiwibank. KGC's shareholding Ministers will retain various levers, including:

- a setting of strategic objectives for KGC through a letter of expectations with those expectations then reflected in the various statements (such as statement of intent) that will be prepared, consulted on with Ministers, and published by KGC's board. Those objectives would cascade down to KGH, Kiwibank and other operating businesses in the group. [25]
- b [25]
- c
- d determining whether to provide any significant new equity capital needed by Kiwibank (or elsewhere in the group) because KGH and KGC do not have independent sources of capital.

Next Steps

40. Planned activity in July includes completing the bulk of the due diligence, negotiating the final form of the SPA, contacting potential board members for the Crown vehicle if Ministers provide feedback on the shortlist of potential directors, and negotiating agreements with KGH shareholders. Detailed planning for the announcement of the transaction and the associated communications materials will be completed.

Appendix: Project Korimako – Target timetable

		w/c	Jun				Jul				Aug					Sep				Oct			
		Date	6	13	20	27	4	11	18	25	1	8	15	22	29	5	12	19	26				
Due diligence	Due diligence	13 June – 22 July	[Bar spanning from 13 Jun to 22 Jul]																				
	Red flag DD reports	27 June			◆																		
	Draft DD reports + valuation report	13 July							◆														
	Final DD reports + valuation report	22 July									◆												
Transaction documentation	Draft SPA issued (+ Crown Deed waiver)	22 June			◆																		
	SPA negotiations	23 June – 1 August	[Bar spanning from 23 Jun to 1 Aug]																				
	SPA signing	2 August											◆										
Ownership matters	Director appointments	20 June – 15 August	[Bar spanning from 20 Jun to 15 Aug]																				
	Crown company establishment ^{1,2}	16 August												◆									
Approvals ³	Cabinet approval of appropriation + delegation of authority for the transaction	4 July							◆														
	Ministerial approval of transaction (under delegated authority)	1 August											◆										
	Cabinet approval of Director appointments	15 August												◆									
	Regulatory approval	3 August – 30 September	[Bar spanning from 3 Aug to 30 Sep]																				

Notes:

- At the point the Crown company is established, the Crown will have received Cabinet approval to appoint the directors to the board of the new Crown company
- If there is an interim Ministerial holding of KGH shares, these will subsequently be transferred to the new Crown company
- A number of external approvals will also be required that are outside of the Crown's control and could impact signing / share transfer timing
- Kiwibank may determine NZX disclosure rules are triggered in preceding weeks

Signing / announcement⁴
(2 Aug)

Settlement / share transfer from selling KGH shareholders
(3 Oct)