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Title: **Cabinet Paper: DEV-21-SUB-0134: Kiwi Group Holdings Limited: Ownership Considerations**

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Kiwi Group Holdings Limited: Ownership Considerations

Proposal

1. This paper informs Cabinet of work underway to determine the future ownership arrangements for Kiwi Group Holdings Limited (KGH). It informs Cabinet of the direction of decision-making regarding KGH ownership, including stated Government objectives and possible opportunities for KGH that have been identified to date, which I propose to further explore, and on which Treasury is providing me with advice.

Executive Summary

2. KGH, the parent holding company of Kiwibank Limited (Kiwibank), was established and wholly owned by New Zealand Post (NZ Post), until October 2016, when the New Zealand Superannuation Fund (NZSF) and the Accident Compensation Corporation (ACC) purchased 25% and 22%, respectively. Today 53% of KGH continues to be held by NZ Post.
3. Due to the diverging operational strategies of NZ Post and Kiwibank, the NZ Post board no longer sees a strategic rationale for it to remain invested in KGH and its preference is to divest its shares as soon as practicable. NZ Post's focus is now on positioning its business for a future in parcels and managing mail volume decline. I am supportive of the board's positioning.
4. In contrast, NZSF and ACC continue to view KGH as a longer-term investment which has considerable potential to grow its activities and value, [25], [26] and [37]
The increasingly divergent interests of NZ Post on the one hand and NZSF and ACC on the other regarding KGH could affect decision-making at KGH and inhibit its longer term prospects if left unchanged.
5. It is likely that NZ Post would have sold further shares in KGH to ACC and NZSF if not for expectations that shareholding Ministers included in the last three annual Letters of Expectations to NZ Post's Board. Ministers imparted an expectation that NZ Post holds its majority interest in KGH until the Crown has determined its preferences for KGH so that optionality for the Government is maintained regarding its future ownership preferences for KGH and the degree of influence the Crown has to progress these.
6. The agreements put in place at the time of the 2016 transaction, which bind the three current shareholders and the Crown, provide that during the five-year period to 31 October 2021 (the "lock-up date") the current shareholders can transact in KGH shares themselves but not with the Crown or other parties. After the lock-up date, the options for transacting shares open up,

but the Crown has the right to buy any shares in KGH that are not taken up by existing shareholders.

7. Given the current positioning of the existing shareholders regarding KGH ownership, the need for better shareholder alignment to support KGH's potential, and the impending contractual milestone, I am now seeking to determine preferences for, and the Crown's negotiating position regarding, the ownership of KGH on behalf of the Government.
8. I have so far determined that the Government's primary objectives for KGH include that Kiwibank, in particular, should:
 - 8.1 remain within New Zealand ownership (expressed indirectly or directly through the Crown), have some level of Crown influence as to its objectives, and
 - 8.2 be differentiated from other banks and a "disruptor" in the banking market.
9. There is recognition however that for Kiwibank to be a sustainable banking operation and a strong market competitor it needs to act commercially.
10. Based on those primary objectives, I have so far narrowed down the opportunities that I would like to further investigate to those that fall within the following categories:
 - 10.1 full and at least partly indirect Crown ownership, with NZSF and potentially ACC maintaining or increasing their shareholdings, or full direct Crown ownership,
 - 10.2 [33], [37], [38]
 - 10.3 [37]
11. I am not advancing potential options that do not enable key objectives regarding Kiwibank as a disruptor, and it remaining within the ultimate ownership of the Crown over the longer term.
12. Within the options to be assessed is a proposal put forward from NZSF to undertake a controlling interest in KGH. NZSF intends to support the development of Kiwibank and Kiwi Wealth (the second largest subsidiary within KGH) and believes these companies have strong outlooks if supported by owners with a shared vision and preparedness to invest. [33]

13. [33], [37], [38]

14.

15. [37]

16.

17. Following a period of further exploration, once I have reached indicative views on preferences for a narrowed set of ownership arrangements for KGH, [33], [37]

Background

KGH is the holding company of Kiwibank and Kiwi Wealth

18. KGH is a non-trading company which wholly owns Kiwibank (representing around 90% of the market value of KGH), and other adjacent subsidiaries including Kiwi Wealth, Kiwi Insurance, and Kiwi Home Loans.

19. Kiwibank was established in 2001 and grew strongly under the ownership of NZ Post, with which it shared a retail network for the following 20 years (until

their progressive separation over last five years, reflecting the companies' diverging strategies). Kiwibank now holds over 8% of New Zealand's residential mortgage market, with a high concentration (around 87%¹) of its loan book in home loans. It has become New Zealand's fifth largest registered bank, after the Big 4, and there is considerable scope for growth in the small-to-medium enterprise (SME) market (as well as continuing to gain share of home lending) if supported by its shareholders.

20. Kiwi Wealth has also experienced strong growth since establishment including through its acquisition of Gareth Morgan Investments in 2012. The company is one of the larger players in a funds management marketplace that is far less concentrated than the market for banking services, and its competitive position was reinforced when its continuing status as a default Kiwi Saver provider was confirmed last month.

The current ownership structure of KGH is a result of a 2016 transaction

21. KGH is currently owned 53% by NZ Post, 25% by NZSF and 22% by ACC. The agreements which brought ACC and NZSF in as shareholders of KGH alongside former 100% owner, NZ Post, on 31 October 2016, have a contractual "lock-up" period to 31 October 2021. During this five-year period, only ACC, NZSF and NZ Post can buy or sell KGH shares.²
22. After 31 October 2021 the three existing KGH shareholders continue to have priority over any share transactions, however, any KGH shares available for transfer that are not acquired by the other KGH shareholders can be offered to the Crown.³ Shares offered but not taken up by other existing KGH shareholders or the Crown may be offered to third parties. The Crown therefore has effective control over whether all KGH shares remain owned (indirectly or directly) by the Crown.

Changes are sought to the ownership structure by KGH shareholders

23. NZSF and ACC view KGH – especially Kiwibank – as a longer-term investment which they consider has the potential to grow significantly in terms of value and market influence, [25], [26] and [37]
NZ Post has a shorter-term timeframe for its KGH investment and is unwilling to direct additional capital to support KGH's growth. The objectives for KGH of each of the three shareholders have therefore diverged.
24. The NZ Post board no longer sees a strategic rationale for the company to remain invested in KGH. Common ownership of NZ Post and Kiwibank no longer provides strategic synergies that a past joint retail network used to provide (through cross selling of services and shared property costs). NZ Post's focus is now on managing the decline in mail volumes and investing in

¹ Compared to the Big 4 banks [housing to total lending]: ANZ [67%], ASB [68%], BNZ [53%] and Westpac NZ [63%].

² Unless all the KGH shareholders and the Crown were to agree to an alternative arrangement.

³ Shares can be transferred from NZ Post to the Crown, subject to certain conditions.

the future of its parcel business. Its preference is to divest its shares in KGH as soon as practicable.

25. The view of the current shareholders is that the status quo is not the best way to support KGH's operating companies to achieve their full potential. The Treasury's advice supports this view but it remains an open question whether the currently specified objectives of KGH are sufficiently aligned with those of the Government's own ambitions for the indirectly Crown-owned bank.
26. Given the positioning of the current shareholders regarding KGH ownership, the need for better shareholder alignment, and the impending contractual milestone, I am seeking to establish the Crown's preferences and negotiating position regarding KGH in order to achieve the best overall outcome.

Pivotal change is happening in the banking sector

27. Decisions on KGH ownership will be made in the current context of the wider banking sector. The sector is dominated by the Big 4 (which collectively represent around 88% of total banking assets in New Zealand). Kiwibank has become a significant bank in the market but even in home lending it lacks the scale of the larger banks.
28. The banking sector is currently characterised by low retail interest rates and an unsustainable pace of house price growth. While banks can set lending rates to reflect the higher risk profiles of lending to businesses, lending on home loans carries a relatively low risk weighting compared to business lending when banks calculate their regulatory capital requirements. Registered banks therefore appear to be preferring residential lending over business lending as under prudential regulations, less capital is needed to support a given level of lending for homes than for businesses. This dynamic means there may potentially be less emphasis to provide credit in other more risky parts of the market through registered banks.
29. The sector is facing pivotal change due to evolving technology needs and customer demand for new ways of banking, and increasing capital and other regulatory requirements (on both sides of the Tasman for the Big 4). Most banks will need to invest in technology to meet the increasing digital needs of customers and new regulations that limit the extent of the outsourcing activities (which is particularly pertinent for the Big 4 outsourcing to their Australian parents). These changes may also drive the Big 4 to review their nature and extent of operations in New Zealand. Westpac Australia has cited these issues in its decision to review the options for its business here, but other factors may also have influenced this decision.
30. There is therefore a question as to how the Government would prefer the Crown's interests in KGH to be held, so as to most effectively position and support Kiwibank as an emerging significant market player. ^[37]

[37]

The Government is entering a negotiating period on ownership changes for KGH

31. Each of the KGH Shareholders have stated their positions regarding KGH, through a combination of submissions and conversations I have had with shareholder Chairs. Of the positions stated, NZSF's is the most formalised in terms of putting forward a proposal for change based on its vision for the future of KGH. [25], [37]
32. NZSF considers that the current ownership arrangements for KGH hinder the group's ability to achieve its potential. It considers that both of KGH's main operating subsidiaries (Kiwibank and Kiwi Wealth) have a strong outlook if supported by owners with a shared vision and preparedness to invest.⁴
33. NZSF is therefore positioning itself to focus on growing the near-to-long term outlook and performance of KGH if it remains invested.
34. [33]
35. [33]
the NZ Post Board stating that it is seeking to divest as soon as possible, has prompted these discussions between the Crown and the current shareholders of KGH. In light of NZSF and NZ Post's positions and the nearing of the end of the "lock up" period for KGH shareholders, the onus is now on the Crown to determine its preferences for the ownership of KGH.

Government objectives to be considered in determining preferred ownership

36. The Government's preferred ownership arrangement for KGH will depend on our objectives for the banking sector and how those objectives might be supported through bank ownership. Following preliminary advice from the Treasury I have so far identified the primary preferred objectives regarding future ownership arrangements for KGH (or for Kiwibank, in particular) as being:
 - 36.1 Long-term New Zealand ownership of Kiwibank (expressed indirectly or directly through the Crown),
 - 36.2 [25]

⁴ NZSF's vision for KGH is one in which its main operating subsidiaries can become world class financial service providers of scale that can drive competition and innovation in the New Zealand banking market, improve customer outcomes via better service offerings and lower service costs, whilst achieving a commercial level of profitability and returns to shareholders.

- 36.3 For Kiwibank to be a disruptor bank, and
 - 36.4 For it to act commercially (recognising this is a minimum need for the bank to continue to be self-sustainable).
37. [25], [33]

Opportunities have been narrowed down

38. Based on those primary objectives, I have so far narrowed down the opportunities that I would like to further investigate to those that fall within the following categories:
- 38.1 full and at least partly indirect Crown ownership, with NZSF and potentially ACC maintaining or increasing their shareholdings (NZSF's and variations on this proposal fall into this category), or full direct Crown ownership,
 - 38.2 [33], [37], [38]
 - 38.3 [37]
39. Within the first area to be explored, there may be a variety of ownership configurations which give NZSF, ACC, and possibly even the Crown directly, different proportions of shares in KGH. I consider there is merit in exploring indirect Crown ownership options via at least one of NZSF, ACC and/or the Crown directly, and I intend to:
- 39.1 first determine whether it is preferable for NZSF to take on a controlling interest in KGH, through understanding the implications and merits of this. [33]
 - 39.2 engage further with NZSF and ACC to better ascertain the parameters and terms that they will, or will not, be willing to trade-off so that each party can seek to maximise each of their objectives to the extent possible; and
 - 39.3 then enter into formal negotiations with the current shareholders to arrive at an agreed arrangement.

40. [33], [37], [38]

41.

42. [37]

43.

44. Options that are not being further considered are those which see majority ownership of KGH outside of the Crown sphere; a partial listing (mixed ownership model, similar to that of the listed Crown-owned energy companies); [33], [37], [38]

I consider that these options do not provide the Crown with sufficient ability to influence the future direction and ultimate ownership of KGH.

[33]

45. [33]

46. [33]

47.

48.

Next steps

49. I am currently now informing Cabinet on the direction of the decision-making regarding KGH ownership, including the stated Government objectives and possible ownership options that have been identified to date, as outlined in this paper.

50. The indicative next points at which I may be seeking endorsements or decisions from Cabinet are:

50.1 [33]

50.2 *Between August and October 2021: endorsement* on the preferred ownership configuration(s) for KGH ownership. Determining the preferred ownership configuration(s) will be dependent on having sufficiently advanced my understanding of the positions of KGH shareholders, [33], [37], [38] which may have advanced by this point. After this point, the Crown and/or the current shareholders [33], [37], [38] will negotiate the terms of any agreed arrangement.

Financial Implications

51. The cost to the Crown for direct ownership holding will be in proportion to any direct Crown ownership interest (with 100% being around \$2 billion), less any amount returned to the Crown by NZ Post. This will have a corresponding impact on net core Crown debt.

52. In the event that NZ Post disposes of all or a portion of its current 53% share in KGH, the Crown should anticipate a special dividend from NZ Post for all

or a majority portion of the sale proceeds (subject to agreeing the quantum that NZ Post will need retain for its business needs, if any).

53. There may be expenditure associated with the due diligence, negotiations and associated transaction costs, depending on the chosen pathway(s) for KGH ownerships changes. Associated costs will be higher if there is a direct Crown ownership element, as the Crown would then become a 'purchasing party', but will be minimal if shares in KGH are re-allocated within the current shareholding group. Costs would be incurred in 2020/21 and 2021/22 will be included in the 2020/21 Additional Supplementary Estimates and Budget 2022 thereafter.

[33]

54. [33]

Impact Analysis

55. A regulatory impact analysis may be required, depending on the chosen pathway(s) for KGH ownership.

Consultation

56. No other agencies were consulted in the development of this Cabinet paper.

Communications

57. There are currently no communications implications.

Proactive Release

58. This paper will not be proactively released, given the commercially sensitive nature of the information within.

Recommendations

I recommend that the Committee:

1. **note** that there is work underway to determine the future ownership arrangement for Kiwi Group Holdings Limited (KGH).
2. [33]
3. **note** that discussions between the Crown and the current shareholders of KGH regarding the ownership of KGH have commenced and have been prompted by the New Zealand Superannuation Fund (NZSF) and New Zealand Post (NZ Post) having stated their positions to further invest and divest, respectively.
4. **note** that there could be substantive changes to the configuration of the banking sector which may be driven in part by core business strategies and/or responses to regulatory changes.
5. **note** that following preliminary advice from the Treasury I have identified the Government's primary preferred objectives regarding future ownership arrangements for KGH (or for Kiwibank, in particular) as being:
 - 5.1 Long-term New Zealand ownership of Kiwibank (expressed indirectly or directly through the Crown),
 - 5.2 [25]
 - 5.3 For Kiwibank to be a disruptor bank, and
 - 5.4 For it to act commercially (recognising this is a minimum need for the bank to continue to be self-sustainable).
6. **note** that, based on the primary objectives identified, I am investigating the following opportunities:
 - 6.1 full and at least partly indirect Crown ownership, with NZSF and potentially ACC maintaining or increasing their shares, or full direct Crown ownership,
 - 6.2 [33], [37], [38]
 - 6.3 [37]
7. [33], [37], [38]

[33], [37], [38]

8. [37]

9. **note** that funding for expenditure associated with the due diligence, negotiations and associated transaction costs, depending on the chosen pathway, may be sought. Costs would be incurred in 2020/21 and 2021/22 will be included in the 2020/21 Additional Supplementary Estimates and Budget 2022 thereafter.

Authorised for lodgement

Hon Grant Robertson
Minister of Finance