

Reference: 20240692

30 September 2024



Dear [REDACTED]

Thank you for your Official Information Act request, received on 2 September 2024. You requested the following:

- *Aide Memoire T2024/1753: Process: FEC Inquiry into Climate Change Adaptation*
- *Treasury Report T2024/1934: Fiscal Sustainability Programme Phase two*
- *Treasury Report T2024/1129: Scope of amendments to the Public Finance Act 1989*
- *Treasury Report T2024/1959: Responses to FEC post-hearing questions for the 2024/25 Estimates of Appropriations*
- *Aide Memoire T2024/1990: Fiscal implications from public private partnerships*
- *Aide Memoire T2024/1999: Local government funding and financing tools*
- *Treasury Report T2024/1745: Kiwibank Competitiveness Considerations*

Information being released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	4 July 2024	Aide Memoire T2024/1753: Process: FEC Inquiry into Climate Change Adaptation	Release in part
2.	17 July 2024	Treasury Report T2024/1934: Fiscal Sustainability Programme Phase two	Release in part
3.	22 July 2024	Treasury Report T2024/1129: Scope of amendments to the Public Finance Act 1989	Release in part
4.	23 July 2024	Treasury Report T2024/1959: Responses to FEC post-hearing questions for the 2024/25 Estimates of Appropriations	Release in full
5.	25 July 2024	Aide Memoire T2024/1990: Fiscal implications from public private partnerships	Release in full
6.	25 July 2024	Aide Memoire T2024/1999: Local government funding and financing tools	Release in part
7.	31 July 2024	Treasury Report T2024/1745: Kiwibank Competitiveness Considerations	Release in part

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I have decided to release the documents listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- section 9(2)(ba)(i) – to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied,
- section 9(2)(b)(ii) – to protect the commercial position of the person who supplied the information, or who is the subject of the information,
- section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials,
- section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions,
- section 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,
- section 9(2)(i) - enable a Minister of the Crown or any public service agency or organisation holding the information to carry out, without prejudice or disadvantage, commercial activities,
- section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage, and
- section 18(c)(ii) – that the making available of the information requested would constitute contempt of court or of the House of Representatives.

Direct dial phone numbers of officials have been redacted under section 9(2)(k) in order to reduce the possibility of staff being exposed to phishing, social engineering and other scams. This is because information released under the OIA may end up in the public domain, for example, on websites including Treasury's website.

Please note that item 2, *Treasury Report T2024/1934: Fiscal Sustainability Programme Phase two* has three documents appended. At the time of providing this advice, the documents were in draft form, before being subsequently updated for publication of lodgement to Cabinet. Any released documents are provided in their final form:

- *CO (24) 4: Performance Plans: Requirements and Expectations* is publicly available: <https://www.dPMC.govt.nz/publications/co-24-4-performance-plans-requirements-and-expectations>,
- *Draft Performance Plan Template* is withheld in full under s9(2)(f)(iv).

Item 4, *Treasury Report T2024/1959: Responses to FEC post-hearing questions for the 2024/25 Estimates of Appropriations* attachment:

- *2024/25 Estimates of Appropriations for Vote Finance* is publicly available on the Parliament website: <https://www.parliament.nz/en/pb/sc/submissions-and->

[advice/document/54SCFIN_EVI_f7e5942e-ea64-497a-6d2a-08dc80ee0281_FIN2580/responses-to-post-hearing-questions-vote-finance](#)

Accordingly, I have refused your request for the attachments in the documents listed in above under section 18(d) of the Official Information Act, as the information requested is or will soon be publicly available.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Reubhan Swann
Manager, Ministerial Advisory Service

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Reference: T2024/1753

Date: 4 July 2024

To: Minister of Finance (Hon Nicola Willis)

Aide Memoire: Process for the FEC Inquiry into Climate Adaptation

This Aide Memoire provides:

- an update on the Finance and Expenditure Committee (FEC) inquiry into climate adaptation, and
- our plan to keep you informed of its progress with weekly (as needed) updates on our advice to FEC and ensure that it reflects Government direction and does not get ahead of Government decisions.

The purpose of the inquiry is to “*develop and recommend high-level objectives and principles for the design of a climate change adaptation model for New Zealand, to support the development of policy and legislation to address climate adaptation*”.

The FEC is scheduled to report to the House by 5 September 2024. Given the scope of the terms of reference, the committee may make recommendations on specific system settings and legislation. s9(2)(f)(iv)

Treasury officials are acting as co-advisors to the inquiry alongside officials from the Ministry for the Environment (MFE). As you agreed in your letter to Committee Chair Hon Stuart Smith on 28 May 2024, we will be available to the FEC to support them to consider policy options and provide information on request but will not make recommendations towards a specific outcome.

The expected pace of the inquiry, the scope of the terms of reference, and the extent to which Cabinet have an agreed direction for adaptation policy present significant risks to the inquiry landing on an outcome that you are satisfied with.

As advisers to the FEC, our primary responsibility is to you as the Minister of Finance. This means we will keep you informed of the progress of the inquiry and work to ensure that the advice we provide to the FEC reflects Government policy.

However, Government policy on adaptation is in early stages. There is a risk that we provide advice to the FEC that you are not comfortable with. In addition to providing you with the draft FEC advice, we plan to talk to your advisors and the advisors to the Prime Minister and to the Minister of Climate Change to:

- explore parameters for officials' mandate to present policy options to the FEC, and
- better understand what aspects of Government policy currently under consideration can be shared with the inquiry.

We will update you each week on the papers to FEC

There is little time for the FEC to cover a terms of reference with a broad scope.

s18(c)(ii)

s18(c)(ii)

These weekly updates provide you with an opportunity to provide any specific direction on information officials will be supplying to the FEC.

s9(2)(f)(iv), s18(c)(ii)

We expect to receive from MFE tomorrow a draft of the second paper s18(c)(ii) which we intend share with your office to append to this AM.

s9(2)(f)(iv)

Area	Coverage
s9(2)(f)(iv)	This matter is not directly considered in the inquiry's terms of reference. However, we expect it may be raised in submissions. s9(2)(f)(iv)
	The inquiry is considering this matter through the investment and cost sharing element of its terms of reference.

<p>s9(2)(f)(iv)</p>	<p>The inquiry may consider this matter through the investment and cost sharing element of its terms of reference.</p> <p>We expect the issue of s18(c)(ii) [redacted] and public submissions to the inquiry.</p> <p>s9(2)(f)(iv) [redacted]</p> <p>s18(c)(ii) [redacted]</p> <p>s9(2)(f)(iv) [redacted]</p>
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The Minister of Climate Change will be considering advice on these issues over the same period

We understand the Minister of Climate Change is receiving a briefing from MFE [redacted] s9(2)(f)(iv) this week and will receive further advice on each of the above issues over the coming months. You will be forwarded these briefings for reference.

A briefing s9(2)(f)(iv) [redacted] went to the Independent Reference Group this week. Following their consideration, a revised briefing will go to the Minister of Climate Change (and be forwarded to you) in late July.

Max Christie, Analyst, Climate Change, s9(2)(k) [redacted]
 Alex Hamilton, Team Leader, Climate Change, s9(2)(k) [redacted]

Appendix: Timeline of FEC Papers

The following table provides a list of officials' papers to FEC, alongside examples of issues to be explored. The first column describes when we aim to provide a draft of each to you for your information. The second column describes when FEC plan to consider each paper.

Expected draft to you	FEC meeting	s18(c)(ii)
Final attached to this AM	3 July	
5 July	10 July	
11 July	17 July	
Oral hearings		
18 July	24 July	s18(c)(ii)
25 July	31 July	
1 August	7 August	



TE TAI ŌHANGA
THE TREASURY

Treasury Report: Lodgement of Fiscal Sustainability Programme - Phase Two Cabinet Paper

Date:	Wednesday 17 July	Report No:	T2024/1934
		File Number:	BM-2-15

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Nicola Willis)	Lodge the Fiscal Sustainability Programme - Phase Two Cabinet Paper for consideration at the Cabinet Expenditure and Regulatory Review Cabinet Committee on 23 July 2024	18 July 2024

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Gabriel Simpson	Analyst, Spending Review	s9(2)(k)	N/A (mob) ✓
Awhi Fleming	Manager, Spending Review	s9(2)(g)(ii)	

Actions for the Minister's Office Staff (if required)

Return the signed report and lodge attached Cabinet paper.

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Treasury Report: Lodgement of Fiscal Sustainability Programme - Phase Two Cabinet Paper

Purpose of Report

1. This report provides you with a final version of the Fiscal Sustainability Programme – Phase Two Cabinet paper and seeks your agreement to lodge the paper for consideration at the Cabinet Expenditure and Regulatory Review Committee (EXP) on 23 July 2024.

Adjustments to the paper

2. You last saw the draft Cabinet paper on 7 July prior 2024 to Ministerial consultation.
3. We have received one response from Minister Brown's office and have incorporated minor adjustments to the Cabinet paper as a result (further details below).
4. We have spoken with the Cabinet Office regarding the draft Cabinet Office circular. They provided one piece of feedback (to remove the contents page given its short length) and were otherwise comfortable. We have therefore removed the contents page and made one minor amendment to address some of Minister Brown's feedback on clarity (further details below). The Cabinet Office has informed us that it can take one to two weeks to format and publish a Circular post Cabinet agreement. However, if you are comfortable with its content, you can send it out to Ministers immediately noting it will be formally published shortly after.
5. We have also continued to refine the Performance Plans template (Annex B of the Cabinet paper), including as a result of pilot agency testing and internal consultation.

Ministerial Consultation

6. We received one response through Ministerial consultation from Minister Brown's office. The feedback regarded clarifying the definition of agency/department for the purpose of preparing a Performance Plan. We have updated the Cabinet paper to clarify this (see the 'Entities covered' section in paragraph 29) and will provide further explanation on this in the guidance for agencies alongside the commissioning of Performance Plans. We have also updated paragraph 6 in the Cabinet Office Circular.
7. Minister Brown also provided feedback on situations specific to Vote Transport (i.e. how KiwiRail monitoring is presented). We have covered this in the Performance Plan guidance for agencies and clarified the text in the Cabinet paper to be clear that any entity monitored and/or funded by a department should be included. This means that we would expect KiwiRail to be reflected in Performance Plans for the Treasury (as the primary monitor/performance lens) and the Ministry of Transport (as the funder for public policy services via Vote Transport). We will speak directly with the Ministry of Transport to clarify this, if required post receiving the guidance.
8. The feedback also included a question about where to reflect potential future budget bids in the Performance Plan template. We have provided your office with communications on this consistent with paragraph 29 (content section) of the Cabinet paper – i.e. Performance Plans be prepared on the basis that agencies will not receive additional funding for cost pressures in future Budgets (unless otherwise instructed).

Adjustments made to the Performance Plan template

9. As previously advised, we have engaged with several agencies to test the workability of the Performance Plans template and have sought feedback on the practice of developing a Performance Plan (T2024/1639 refers). The pilot process, including engagements with Statistics NZ, Customs, Treasury and the Ministry of Business, Innovation and Employment, has provided valuable insights for the design of the template and development of guidance documents. Key points of feedback included:
- a **Minor changes for ease of use** - such as, ensuring consistency in data time periods for graphs, reordering section for more logical flow, and adjusting section sizes to allow for more information to be provided in particular areas.
 - b **Areas where clarity was required in guidance** - such as ensuring clear definitions and requirements are given for each section, s9(2)(f)(iv)
 - c **Highlighting areas that will be challenging for agencies** – s9(2)(f)(iv)
- . The usefulness of some graphs and opportunities to show that information in different ways was also raised.
10. Adjustments have been made to the template to incorporate this feedback. We believe that these changes do not substantially alter the content to be collected/provided through Performance Plans, but do make it easier for agencies to follow and provides more clarity on the key areas of focus. The changes we have made include:
- Reformatting of the template for consistent flow and usability, including:
 - s9(2)(f)(iv)
 -
 - Allowing more space where required to ensure an adequate amount of detail can be presented s9(2)(f)(iv)
 - s9(2)(f)(iv)
 - Adjusting titles, prompt questions, definitions and graph labels to be clearer to agencies and more consistent for the reader.
 - s9(2)(f)(iv)
11. The template is in near-final draft form for inclusion in the Cabinet paper. Further minor or technical adjustments may be required prior to the commissioning of Performance Plans.
12. We have also developed agency guidance to cover more detailed information required to support agencies in preparing their Performance Plans (particularly in areas where agencies have highlighted they may have difficulties).

13. Attached as Annex B to the Cabinet paper is the current draft template taking on board these comments. We are continuing to review the template and will be making any final amendments (following further internal consultations and discussions with central agencies) ahead of Cabinet agreement. These changes are primarily format-oriented, technical or for quality assurance purposes.

Next Steps

14. Subject to your agreement to this report, the Cabinet paper will be lodged on 18 July 2024 for EXP on 23 July 2024 and Cabinet on 29 July 2024.
15. We are preparing to formally commission Performance Plans immediately after Cabinet, subject to its endorsement on 29 July 2024. This includes:
- a Providing you with letters to send to individual Ministers advising them of Cabinet's agreement and attaching the Cabinet Office Circular. We view this as an important step noting that Performance Plans are owned by Ministers and not all Ministers will sit on EXP and Cabinet. We expect to send you these letters for consideration in your weekend bag on 26 July 2024.
 - b The Treasury following up with an email to executive leadership teams providing them with the template and guidance.
 - c Setting up an information session for all agencies in the days after to answer any questions they may have.

Recommended Actions

We recommend that you:

- a **agree** to lodge the attached Fiscal Sustainability Programme – Phase Two Cabinet paper (Attached as Appendix A), on 18 July 2024 for consideration at the Cabinet Expenditure and Regulatory Review Committee on 23 July 2024; and
Agree / Disagree
- b **note** that Treasury will provide you with Performance Plan commissioning letters to send to Ministers as part of the Performance Plans implementation process ahead of Cabinet's consideration.

Draft Cab Office Circular - Performance Plans: is publicly available: <https://www.dPMC.govt.nz/publications/co-24-4-performance-plans-requirements-and-expectations>

Draft Performance Plan Template is withheld in full under s9(2)(f)(iv)

Awahi Fleming
Manager, Spending Review

Hon Nicola Willis
Minister of Finance

_____/_____/_____

Office of the Minister of Finance

Chair, Cabinet Expenditure and Regulatory Review Committee

Fiscal Sustainability Programme - Phase Two

Proposal

- 1 This paper sets out the fiscal context ahead of Budget 2025 and key tools we have through the Fiscal Sustainability Programme to ensure we can achieve our fiscal and policy objectives.
- 2 I seek agreement to the design of Performance Plans, which are a cornerstone of the Fiscal Sustainability Programme, to enable their commencement.

Executive Summary

- 3 Our fiscal strategy is to consolidate, reduce core Crown expenses and net core Crown debt as a proportion of GDP and return to operating balance before gains and losses (OBEGAL) surplus by 2027/28. This is critical to reducing inflation and tackling the cost-of-living crisis. We are doing this through embedding a culture of responsible spending, restoring fiscal discipline, right-sizing the government's footprint, and improving the efficiency and productivity of spending.
- 4 Allowances for Budgets 2025 to 2027 are set at \$2.4 billion per annum. They are deliberately small since constraining new spending is our primary top-down tool to manage fiscal consolidation. s9(2)(f)(iv)
[REDACTED] We will remain within these tight allowances through a combination of spending constraint, savings, revenue, and reprioritisation.
- 5 At Budget 2024, we laid the foundations to achieve our fiscal strategy and we are embarking on Phase Two of the Fiscal Sustainability Programme, which focuses on driving greater value for money from public expenditure and securing a sustainable fiscal outlook across the term.
- 6 Other components of Phase Two that Cabinet previously agreed are underway, with a particular focus on measures aimed at securing savings for Budget 2025. s9(2)(f)(iv)
[REDACTED] I intend to report back prior to Budget 2025 on these matters and to keep Cabinet regularly informed of our progress on the Fiscal Sustainability Programme.
- 7 Today, I am seeking your agreement to the design of Performance Plans, which are an essential component of Phase Two. Performance Plans will bring together information and insights (e.g. on agency strategy, allocation, prioritisation, and performance) to:
 - 7.1 provide assurance to Ministers that each agency has a plan in place to deliver within set baselines, subject to Ministerial comfort with associated trade-offs (**supports fiscal sustainability**); and

- 7.2 transparently and systematically surfacing fiscal sustainability, agency performance and delivery risks to Ministers, identifying levers available to address these and confirming the ongoing approach to managing them (**active management and agency performance**).
- 8 The introduction of Performance Plans will send a strong signal that we expect that departments manage within baselines, helping constrain spending in Budget 2025 and beyond. They will also promote medium-term planning and risk management, and set us up for future Budgets by surfacing medium-term pressures and options to address them. I propose that Performance Plans are owned by the Responsible Minister and for the Cabinet Expenditure and Review Committee (EXP) to review aggregate-level advice on the trade-offs, immediate and longer-term risks and impact on Budget 2025 and beyond.

Background

Economy and Fiscal context

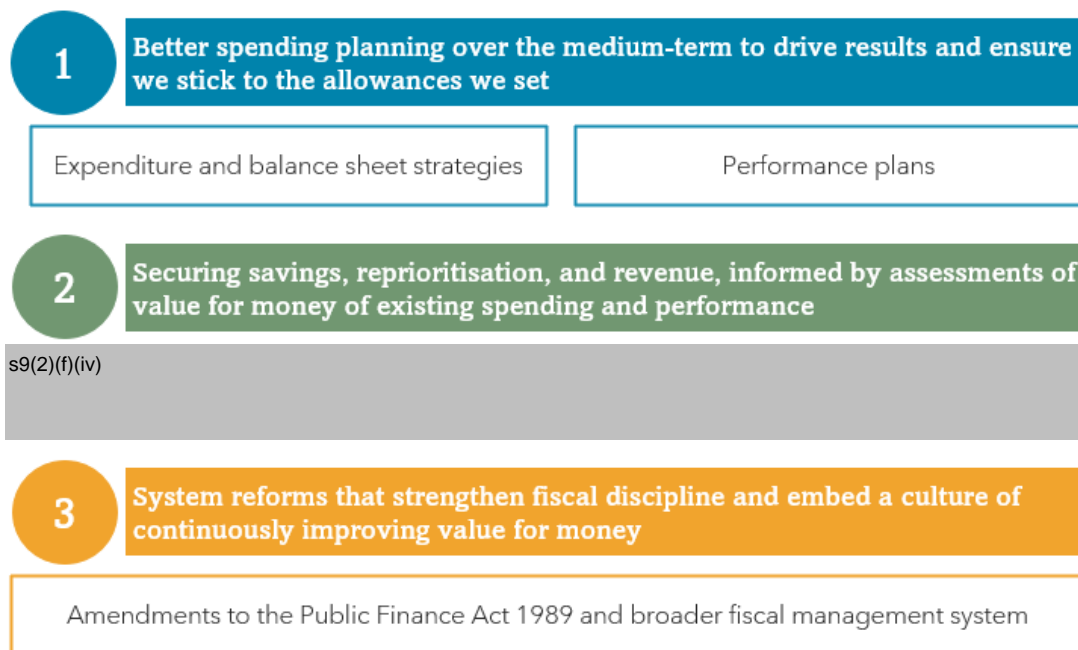
- 9 New Zealand is experiencing an economic downturn. Economic activity has been weak since late 2022 and although inflation is declining from its peak, it still remains too high. While the economy is expected to rebound in the years ahead, the Treasury forecasts economic activity to remain subdued in the near-term as monetary policy continues to drag on domestic spending and global growth remains modest.
- 10 Coupled with weaker-than-expected business income taxes, these conditions translate to soft growth in tax revenue over the forecasts. With growth in core Crown expenses remaining high in the near-term, this sees OBEGAL deficits staying elevated this year and next and net core Crown debt continuing to rise.
- 11 Our fiscal strategy is to consolidate, reducing core Crown expenses and net core Crown debt as a proportion of GDP and returning OBEGAL to surplus. Given the constrained outlook, living within tight Budget operating allowances is our primary top-down tool to deliver fiscal consolidation, and we have agreed allowances for Budgets 2025 to 2027 of \$2.4 billion per annum.
- 12 s9(2)(f)(iv) [REDACTED]
- As a result of these constrained allowances, most departments will have to manage cost pressures within baselines (i.e. without additional funding) and any proposals for new spending will have to be met first by the reprioritisation of existing resources. I wrote to you all on 25 June 2024 outlining this expectation.

Fiscal Sustainability Programme

- 13 We established the Fiscal Sustainability Programme in December 2023 to provide the architecture for delivering our fiscal strategy across the term [CAB-23-MIN-0490 refers].
- 14 The objectives of the Fiscal Sustainability Programme are:
- 14.1 generating sufficient reprioritisation, savings, and revenue-raising measures to fund the Government's priorities and deliver enduring improvements in the OBEGAL position;

- 14.2 strengthening the public finance system to tighten fiscal discipline and embed a culture of continuously improving value for money; and
- 14.3 ensuring collective ownership and accountability for the fiscal position and value for money at all levels of government [CAB-23-MIN-0490 refers].
- 15 The Fiscal Sustainability Programme is structured in phases, to help sequence activities and ensure time is available to develop longer-term structural changes that may be required.
- 16 Having successfully delivered the first phase through the savings achieved at Budget 2024, we are now moving into the programme’s second phase. This next phase is focused on supporting the Government to manage within the allowances we set for Budgets 2025 to 2027 and create the medium-longer-term cultural changes necessary to support this. This will require us to continue to reprioritise existing funding to its best use, right-size the government’s footprint, and improve the efficiency and effectiveness of spending. Phase Two activities are outlined below:

Figure one: Fiscal Sustainability Programme Phase Two overview



17 Our immediate challenge is securing savings to help meet our policy goals in Budget 2025 while also achieving our fiscal strategy. s9(2)(f)(iv)

18 s9(2)(f)(iv)

19 I expect that further savings options will be needed as part of the Budget process to ensure we can deliver on our Government’s commitments. s9(2)(f)(iv)

- 20 Spending restraint is critical to achieving our goals for Budget 2025 and beyond. This is where Performance Plans come in – ensuring there are credible plans in place for departments to work within existing baselines means that we are in a better position to utilise the remaining allowances on our most important priorities.

Performance Plans

- 21 Within the public finance system, the financial planning horizon is anchored on annual budgets. There are limited mechanisms for departments to regularly discuss financial management with their Minister across a longer horizon,¹ and no mechanisms that bring financial and performance planning together over the medium-term.
- 22 Without a mechanism to surface emerging performance and fiscal issues, the options to rectify these are limited and fiscal intervention is often the only option available. Amending this situation is crucial for the success of the Fiscal Sustainability Programme.
- 23 To address this, we have already agreed that Performance Plans (formerly Savings and Performance Plans) will be a foundational part of the Fiscal Sustainability Programme [CAB-23-MIN-0490 and CAB-24-MIN-0148 refer]. I propose that we implement these now in order to achieve the culture shift necessary to embed fiscal responsibility in the medium-to-longer-term and I am seeking your agreement to the detailed proposals through this paper.

Objectives and benefits

- 24 Performance Plans are intended to be a summary document which enable Ministers, supported by departments, to set out how money is being spent by the department and any companies or entities it is responsible for, and whether this spending is achieving its intended outcomes. They will cover the forecast period² with a longer-term view encouraged, and support our decision making on common risks and immediate or longer-term pressures and opportunities for more strategic decision making.
- 25 The objectives for Performance Plan at an agency and aggregate level are:
- 25.1 Providing assurance to Ministers that each agency has a plan in place to deliver within set baselines, subject to Ministerial comfort with associated trade-offs (**supports fiscal sustainability**).
- 25.2 Transparently and systematically surfacing fiscal sustainability, agency performance and delivery risks to Ministers, identifying levers available to address these and confirming the ongoing approach to managing them (**active management and agency performance**).
- 26 As such, Performance Plans are not just about fiscal restraint, they are also about lifting performance and value across the system and will provide insights into how well funding is utilised to benefit New Zealanders.
- 27 Central agencies will play a role in providing advice to EXP on consolidated risks and opportunities across the Performance Plans as well as information gaps and challenges that may need support to be addressed. The Plans will therefore drive risk management decisions out of the annual Budget cycle, and into a more medium-term perspective.

¹ This is apart from some expectations in the Investment Management Cabinet Office Circular (CO (23) 9).

² The forecast period includes the current financial year and the next four financial years.

28 Lifting performance will take time and I do not anticipate that the Plans put forward initially will meet our full aspirations. However, we need to set our expectations high and reinforce these over time. I will set expectations with central agencies to continue to provide me with advice about how to incentivise and support continual improvement and capability building.

Key Features of Plans

29 I propose that Performance Plans have the following key features:

Feature	Description
Responsibility for plans	<p>Ministers should be the responsible ‘owners’ of Performance Plans. Responsible Ministers, working with their portfolio colleagues, will be best placed to sign out Performance Plans due to their influence over strategy and allocation. Ministerial ownership will ensure appropriate oversight of the priorities and trade-offs being made, collective responsibility, and support strategic conversations amongst ourselves.</p> <p>Where a department has more than one portfolio Minister, the Responsible Minister will have responsibility for the overall Performance Plan and should work with portfolio Ministers to agree it. I recommend there is an option to provide supplementary information at portfolio level (e.g. for departments with many portfolios, such as the Ministry of Business, Innovation and Employment) and/or sectoral level (e.g. where departments work closely together, such as law and order departments) where necessary to provide information at a useful scale, but that Performance Plans be prepared at the departmental level.</p>
Entities covered	<p>I recommend that responsible Ministers have and maintain a Performance Plan for each department³ they are responsible for. Where a department has multiple portfolios, the responsible Minister will need to work together with their colleagues to complete the Performance Plan.</p> <p>The purpose of Performance Plans is to bring together a range of information required to provide Ministers with insights into how government spend is being utilised and managed. I recommend that Performance Plans are prepared at the agency level covering all entities for which they have monitoring responsibilities and/or provide funding to, rather than at an individual vote level. This is to ensure that we receive a fulsome overview of the risks to fiscal sustainability and performance and are therefore, able to make appropriate trade-off decisions (enabling a sectoral view).</p> <p>In line with this, I do not propose that Crown companies and entities prepare a separate Performance Plan. Instead, I recommend that fiscal sustainability and performance issues and opportunities are reflected in the Performance Plan of the monitoring and/or funding department. This will mean that the responsible departments include monitored and funded agencies in all its Performance Plan responses. The Treasury will be releasing guidance to support agencies in completing Performance Plans which will provide more detail on this. We may consider separate Performance Plans for these entities in the future, however, this risks being duplicative and not providing the sectoral view required.</p>

³ As defined in the Public Finance Act 1989, but excluding interdepartmental Boards and interdepartmental ventures. The definition therefore includes the New Zealand Defence Force, New Zealand Police and Parliamentary Counsel Office.

<p>Content</p>	<p>I have attached the draft template (see Annex B). Performance Plans are designed to provide information on agency strategy, allocation, prioritisation, and performance, giving Ministers a comprehensive view of actual and intended performance to support any trade-off decisions.</p> <p>I propose that Performance Plans be prepared on the basis that agencies will not receive additional funding for cost pressures, unless confirmed by me or Cabinet ahead of each Budget. This approach reinforces our expectation of managing within our existing allowances and incentivises continual reprioritisation of low value activities.</p> <p>s9(2)(f)(iv)</p> <p>s9(2)(g)(i)</p>
<p>Reviews, scrutiny and roles</p>	<p>Performance Plans are intended to be part of an ongoing cycle of review and scrutiny.</p> <p>I propose that EXP considers consolidated advice on all Performance Plans in late 2024/early 2025, and at that point EXP can decide whether they want to review any Plans in more depth in February/March 2025 prior to the decision-making phase of Budget 2025. It is not intended that EXP would review all Performance Plans in detail, but it will have visibility of all Performance Plans and central agency advice to enable trade-off discussions to occur.</p> <p>I recommend EXP consider progress against the Performance Plans in aggregate, annually (before the Budget strategy), with updates to Performance Plans made as required. In this regard each Performance Plan becomes a ‘living document’.</p>
<p>Mandate – Cabinet circular</p>	<p>I propose that Cabinet embed the Performance Plan requirements in a Cabinet Office circular due to their ongoing relevance, significance to our fiscal strategy, and wide reach (impacting almost all departments). I am therefore seeking your agreement to the attached draft Cabinet circular, with the view that I will make any final amendments following Cabinet’s discussion before the circular is finalised (see Annex A).</p>
<p>Support for EXP</p>	<p>Central agencies will provide a performance overview of each agency as well as advice on the aggregate picture to inform EXP’s consideration of the key risks, trade-offs and opportunities, and prioritisation of Performance Plan reviews. This will include what interventions may be required at an agency or Ministerial level to manage immediate or longer-term challenges.</p>

Timing

- 30 To ensure Performance Plans are prepared in time for Budget 2025 decisions, I propose the following timeline. I expect Performance Plans to be reviewed annually on a similar timeline to ensure that they feed into future Budget processes.

Activity	Who	Timing
Plans commissioned	Minister of Finance	Late July 2024
Departments and Ministers develop initial Plans	Ministers, Departments	From late July 2024
Central agencies to 'check in' as the Plans develop – s9(2)(f)(iv)	Central agencies, Departments	September – October 2024
Plans agreed between Ministers and departments	Ministers, Departments	November 2024
Central agency advice on the Plans and prioritisation for EXP review	Central agencies	Late 2024/Early 2025
EXP discussion on Plans and recommendations on revisions that may be required	Ministers	Late 2024/Early 2025
Budget package formation and decision making	Treasury, Departments, Ministers	January 2025-April 2025
Finalised Plans agreed between Ministers and departments (taking into account the recommendations from EXP and the outcome of Budget decisions) including agreement on frequency of Plan revisions (i.e. annually or more/less frequently).	Ministers, Departments	June 2025
Commencement of Plan monitoring and reporting	Central agencies, Ministers	TBC

Further Fiscal Sustainability Programme Phase Two components

- 31 Further medium-term activities are being progressed to complement the Fiscal Sustainability Programme tools in progress for Budget 2025 [CAB-24-MIN-0148 refers], in order to achieve system-level behavioural change. These are on a longer timeframe.
- 32 The Treasury is working to develop expenditure and balance sheet strategies. s9(2)(f)(iv)

33 I have also directed the Treasury to develop system reforms to increase fiscal discipline, including by amending the Public Finance Act 1989. This will include measures to improve the transparency of fiscal risks, as well as amendments focused on fiscal responsibility and transparency more generally. s9(2)(f)(iv)

34 I will report back to Cabinet regularly on our progress on these components of the Fiscal Sustainability Programme and ask that you ensure your departments are committed to achieving and delivering these outcomes.

Cost-of-living Implications

35 The proposals in this paper do not have any cost-of-living implications. The cost-of-living implications of any future decisions will be considered by Cabinet at the point those decisions are taken.

Financial Implications

36 The decisions sought in this paper do not have any direct financial implications. The Fiscal Sustainability Programme, including the proposals included in this paper, aim to improve the aggregate fiscal position. The financial implications of any future related decisions will be considered by Cabinet at the point those decisions are taken.

37 I expect the Treasury and other departments to manage the activities of the Fiscal Sustainability Programme noted in this paper within existing baselines.

Legislative Implications

38 The proposals in this paper do not have any legislative implications. The legislative implications of any future decisions will be considered by Cabinet at the point those decisions are taken.

Regulatory Impact Statement

39 There are no regulatory proposals in this paper, and therefore Cabinet's impact analysis requirements do not apply.

Climate Implications of Policy Assessment

40 The proposals in this paper do not have any climate implications. The climate implications of any future decisions will be considered by Cabinet at the point those decisions are taken.

Population Implications

41 The proposals in this paper do not have any population implications. The population implications of any future decisions will be considered by Cabinet at the point those decisions are taken.

Human Rights

42 There are no human rights implications from the proposals in this paper. The human rights implications of any future decisions will be considered by Cabinet at the point those decisions are taken.

Use of external Resources

- 43 The Treasury has seconded one external resource for a fixed time period to support the development of Performance Plans.

Consultation

- 44 Treasury has consulted closely with the Central Agencies in the development of the Performance Plan design and associated processes. Treasury has also consulted with a selection of Chief Executives and finance professionals from across government departments during the development of the Performance Plan proposals. Feedback from these engagements has been considered in the final design of Performance Plans and associated processes.
- 45 Treasury has consulted with the Cabinet Office regarding the Cabinet Circular and no substantive feedback was received. This paper was circulated for Ministerial consultation. Some feedback was received on the definition of agency/department for the purpose of preparing a Performance Plan. Further clarifications have been added into this paper and the Treasury will also be releasing guidance alongside the commission of Performance Plans.

Communications

- 46 I do not currently intend to proactively announce any of the updates or implementation details in this paper at this stage, noting many of the details remain Budget sensitive. I may, however, mention components of Phase Two of the Fiscal Sustainability Programme publicly from time to time.

Proactive Release

- 47 I intend to proactively release this paper at an appropriate time subject to appropriate redactions under the Official Information Act 1982, noting this paper is currently Budget sensitive.

Recommendations

The Minister for Finance recommends that Cabinet:

- 1 **note** that core Crown expenses have increased around 20 percent in real terms since COVID-19 (comparing 2018/19 to 2022/23 fiscal years, adjusted for CPI inflation);
- 2 **note** that, in the current economic environment, achieving our fiscal strategy will be challenging, and require our collective focus and commitment;
- 3 s9(2)(f)(iv)
- 4 **note** that, in December 2023, we established the Fiscal Sustainability Programme to support delivering our fiscal strategy across the term [CAB-23-MIN-0490 refers], and that Phase Two of the Fiscal Sustainability Programme is currently underway;
- 5 **note** that Cabinet agreed to progress Performance Plans as part of the Fiscal Sustainability Programme in December 2023 [CAB-23-MIN-0490];
- 6 **agree** to commission Performance Plans from all departments (using the definition of Departments in the Public Finance Act 1989 excluding Interdepartmental Boards and interdepartmental ventures), in line with the process outlined in paragraphs 29-30 of this paper;

7 **note** that Performance Plans are intended to be iterative, and flexible to the requirements of the day or objectives of the current Government and that their quality will improve over time as capability grows;

8 **agree** that the objectives for Performance Plan at department and aggregate level are:

8.1 providing assurance to Ministers that each agency has a plan in place to deliver within set baselines, subject to Ministerial comfort with associated trade-offs (**supports fiscal sustainability**); and

8.2 transparently and systematically surfacing fiscal sustainability, agency performance and delivery risks to Ministers, identifying levers available to address these and confirming the ongoing approach to managing them (**active management and agency performance**).

9 **agree** that the default position is that all departments should plan on the basis of no additional funding for cost pressures when preparing their Performance Plans;

10 s9(2)(f)(iv)

11

12 **note** that Performance Plans are intended to inform the Budget process, but do not replace it;

13 **agree** that when preparing Performance Plans, Responsible Ministers and/or Lead Ministers should have regard to which expenditure is:

13.1 delivering public goods, social insurance, regulating market failure and political choice; and

13.2 based on data and evidence with programmes stopped if they are not delivering results.

14 **agree** to a new Cabinet Office circular entitled *Performance Plans: Cabinet requirements and expectations*, that sets out Cabinet's expectations for the process of developing and maintaining Performance Plans (attached as Appendix A);

15 **agree** that the new circular will be effective from 30 July 2024, or on a date to be determined by the Minister of Finance;

16 **agree** that the new circular will be effective from 30 July 2024, or on a date to be determined by the Minister of Finance;

17 **authorise** the Minister of Finance to:

- 17.1 make any necessary changes to the circular between the date of Cabinet approval of the circular and the effective date of the new circular, provided these are consistent with the intent of the circular;
- 17.2 make administrative changes over time to maintain the currency of the circular, provided these are consistent with the intent of the circular;
- 18 **invite** the Minister of Finance to report back to the Cabinet Expenditure and Regulatory Review Committee in late 2024/early 2025 with advice from central agencies on the initial Performance Plans;
- 19 **invite** the Minister of Finance to report back to Cabinet on the Budget 2025 strategy, including savings and reprioritisation workstreams;
- 20 **note** that Phase Two of the Fiscal Sustainability Programme is intended to span the course of our term and the Minister of Finance will update Cabinet on further activities and progress as required.

Hon Nicola Willis

Minister of Finance



Treasury Report: Scope of reform of the Public Finance Act 1989

Date:	22 July 2024	Report No:	T2024/1129
		File Number:	ST-7-4-6

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Nicola Willis)	<p>Agree the shorter-term and longer-term approach outlined for reform of the Public Finance Act 1989.</p> <p>Agree to the scope of the Public Finance Amendment Bill.</p> <p>Direct the Treasury to progress further policy work on the proposals identified for the Amendment Bill and indicate if there are additional areas you wish to consider.</p>	31 July 2024

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Tan Lakhawala	Analyst, Public Finance Policy	s9(2)(k)	N/A (mob) ✓
Eóin Welsh	Senior Analyst, Public Finance Policy		N/A (mob)
Tom Hall	Manager, Public Finance Policy		s9(2)(g)(ii)

Minister of Finance's Office Actions (if required)

Return the signed report to the Treasury.

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Treasury Report: Scope of reform of the Public Finance Act 1989

Executive Summary

In December 2023 you indicated that you wish to enact a Public Finance Amendment Bill (the Bill) in this parliamentary term, with a particular focus on fiscal risks alongside other changes to strengthen transparency, fiscal discipline and public sector performance. You successfully bid for a legislative slot in this term, with introduction of the Bill planned in 2025.

This report makes recommendations on the overall scope (both shorter- and longer-term) of PFA reform and, more specifically, the scope of the Bill (to progress this parliamentary term).

The Public Finance Act 1989 (PFA) generally functions well. It supports the Public Finance System (PFS) in three ways – Fiscal Responsibility; Public Accountability & Parliamentary Authorisation; and Public Sector Management – but there are challenges with each of these.

Many of these challenges can be responded to via non-legislative policy actions (for example, via the Fiscal Sustainability Programme). However, legislative changes progressed through the Bill can bolster your non-legislative work programme. We therefore recommend that you pursue a combination of legislative and non-legislative policy actions, introduced over the shorter-term and longer-term.

s9(2)(f)(iv)

- s9(2)(f)(iv)
-
- In addition, the Public Service Commission will provide advice on issues related to public sector management.

s9(2)(f)(iv)

- s9(2)(f)(iv)
-

If you agree, the Treasury will provide further advice to you on the content of the Bill by s9(2)(f)(iv)

Treasury Report: Scope of reform of the Public Finance Act 1989

Purpose of Report

1. This report seeks your decisions on:
 - a the overall scope of reform (in the shorter- and longer-term) of the Public Finance Act 1989 (PFA), and
 - b specifically the scope of the Public Finance Amendment Bill (the Bill) to be progressed this parliamentary term.

Background

2. In late 2023, you indicated concerns with the lack of transparency of fiscal risks (and particularly time-limited funding). Following this, the Treasury advised you on options to improve the disclosure of fiscal risks and time-limited funding, which included potential amendment to the PFA (T2023/2139 refers). At the time you:
 - a agreed to progress the options to address the lack of transparency of fiscal risks, including options to amend the PFA;
 - b agreed that amending the PFA for fiscal risks should be part of a broader package of changes to the PFA, to strengthen transparency, fiscal discipline, and public sector performance; and
 - c indicated your expectation that the PFA is amended in this parliamentary term.
3. s9(2)(f)(iv)
4. This report makes recommendations on the scope of PFA reform and, more specifically, the scope of the Bill. Based on your direction, the Treasury will progress policy development to provide you with final advice on the Bill by s9(2)(f)(iv)
5. A report: Responding to your comments on Treasury reports on performance reporting will be provided shortly [T2024/961]. s9(2)(f)(iv)

The proposed Parliamentary Inquiry into performance reporting would be the appropriate mechanism to progress this.

The Public Finance Act and its functions

6. The PFA forms the legislative core of the Public Finance System (PFS), but the system is broader than that: the PFA works in conjunction with a range of other legislation, including the Public Service Act 2020 (PSA), the Crown Entities Act 2004 (CEA), and other sector-specific legislation (for example, the Pae Ora (Healthy Futures) Act 2022 and the Education Act 1989). Together, these pieces of legislation govern both the PFS and management of the public sector.

7. The PFA is a significant piece of legislation that goes to the heart of the relationship between the Crown and the legislature. The Bill of Rights 1688 established that the levying of money for the Crown without grant of Parliament was illegal. The Constitution Act 1986 recognised this by prohibiting the Crown from levying taxes, borrowing money, or spending public money except under statute. The PFA provides that statutory authorisation, paired with public accountability requirements.
8. The PFA supports the PFS in three ways.
 - a *Fiscal responsibility* – requires that the Government comply with the principles of responsible fiscal management and articulate its fiscal strategy and budget intentions.
 - b *Parliamentary authorisation and public accountability* – authorises the incurring of expenditure and other financial activities (borrowing, securities), and sets the reporting obligations to support Parliamentary scrutiny and public accountability.
 - c *Public sector management* – supports efficient and effective delivery of goods and services by placing financial management responsibilities in the hands of departmental Chief Executives (as a consequence of the Chief Executive responsibilities set out under the PSA), accountable to responsible Ministers, and provides the Minister of Finance and the Treasury with the tools to control the overall fiscal position.

Challenges and opportunities for change

9. Over the years, the PFA has generally fulfilled its roles within the PFS well. There are, however, challenges and opportunities for improvement with each of these roles.
 - a *Fiscal responsibility*: While fiscal responsibility provisions are long-standing and generally effective, they could be strengthened by improving transparency. Furthermore, the PFA does not require an independent account of performance against stated fiscal objectives, or reasons for not achieving stated intentions, to be given.
 - b *Parliamentary authorisation and public accountability*: The focus on reporting performance at both the appropriation and agency level has led to the provision of information that is not meaningful or accessible. In addition, it does not easily provide for reporting on results or performance across agencies.
 - c *Public sector management*: Although effective for delivery of many public services, the vertical accountability of the system can constrain the Government's ability to drive its priorities through the public service. In addition, the system can create silos, making complex issues that require cross-government collaboration more difficult to resolve.
10. There are also concepts and principles which cut across all the roles that the PFA serves, and which also exhibit challenges. For example, the PFA is largely silent on te Ao Māori and the Treaty of Waitangi. s9(2)(f)(iv)

Criteria for change

11. Non-legislative actions can provide levers to respond to the challenges identified in paragraph (9). However, legislative changes can reinforce and complement these levers.
12. In determining legislative responses to the problems identified above, we recommend that you consider the principles stated below:
 - a *Need for legislative change*: the purpose of legislative change needs to be clearly articulated. In general, legislative change should complement non-legislative policy actions rather than being the sole solution.

- b Importance of change and evidence: legislative change should generate significant improvements and should take account of available evidence of its likely effectiveness.
- c The enduring nature of legislation: given the PFA’s significance in the relationship between the Crown and the legislature, changes should be enduring (rather than short-term fixes) and have cross-party consensus.
- d Complexity of change: The PFA, PSA and CEA impact the whole public sector and have implications on various stakeholders. Successful implementation requires any changes to be widely consulted on, and account for resource and time required to develop and implement the changes.

Recommended strategy for change

13. Based on the principles in paragraph (12), we recommend that you pursue a combination of legislative and non-legislative policy actions, introduced over the shorter- and longer-term. This will help you make effective changes in the shorter-term, while considering what is required (consultation, resource, and time) to successfully develop and implement longer-term changes.

14. s9(2)(f)(iv)

- a s9(2)(f)(iv)
- b
- c In addition, the Public Service Commission will provide advice on issues related to public sector management. This will include options for changes in the shorter-term, and for longer-term consideration of deeper change, consistent with the programme outlined in this report.

15. s9(2)(f)(iv)

- a s9(2)(f)(iv)
- b

16. To clarify the sequencing we recommend, we have attached a diagram (refer Annex).

Shorter-term changes

Non-legislative actions

17. A range of non-legislative actions and programmes, largely operating within existing legislation, would have the most significant impact. These programmes respond to some of the challenges identified above (particularly those of fiscal responsibility) while progressing the Government's other priorities.
- a **Fiscal Sustainability Programme:** This programme aims to:
 - i drive greater value and results from public expenditure by using improved information to prioritise resources to high-value activity; and
 - ii secure a sustainable fiscal outlook by bringing revenue and expenses back into balance and ensuring fiscal discipline in decision-making.
 - b **Value for Money:** As part of the Fiscal Sustainability Programme, Ministers will seek to secure greater value and results from public expenditure, by requiring information on performance and using it to allocate funding, including reprioritising resources from lower value activities to high value ones.
 - c **Social Investment:** The Social Investment Agency's work will focus on the quality of impact measurement and will base funding in the social sector on evidence of effectiveness, to increase the impact of spending for vulnerable people.
 - d **Balance Sheet Management:** New Zealand has strong foundations for balance sheet management, including timely accrual accounting. However, the scale and risk profile of the balance sheet have changed substantially since the PFA was passed, placing greater pressure on fiscal sustainability and balance sheet performance. s9(2)(f)(iv)
 - e **Public Sector Management:** A central agency approach to public sector performance will include:
 - i PSC's work to consider an approach to performance that uses performance pay mechanisms and involves responsible Ministers more in the process.
 - ii DPMC's work on the Government's Targets and driving performance.

Legislative actions: Scope of the Bill (this parliamentary term)

18. Based on the principles noted at paragraph (12), we recommend s9(2)(f)(iv)

19. s9(2)(f)(iv)

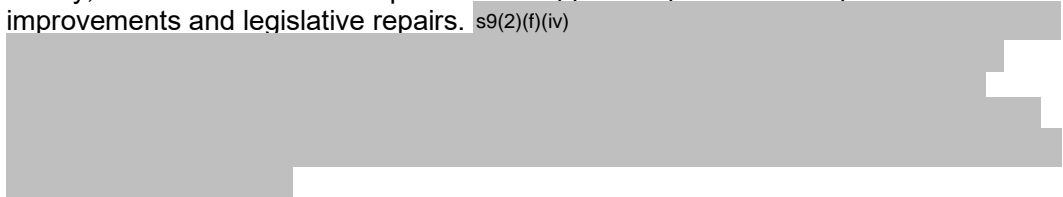
s9(2)(f)(iv)

s9(2)(f)(iv)



20.

21. Finally, a PFA Amendment Bill provides an opportunity to introduce process improvements and legislative repairs. s9(2)(f)(iv)



22. In considering any change to the PFA, you will also need to consider the implications, if any, for the CEA, PSA, and other legislation.

Longer-term changes: systemic legislative opportunities

23. The challenges identified in paragraph (9) above are long-standing and complex, and s9(2)(f)(iv)

24. s9(2)(f)(iv)

Public Accountability

25. Parliament is a key recipient of performance reporting information. They play a crucial role in how the public accountability performance reporting system works. As such, any recommendations that arise from the proposed Parliamentary Inquiry into performance reporting will have significant weight. The Finance and Expenditure Select Committee has recently stated that it will not progress work on the Inquiry until 2025.

26. s9(2)(f)(iv)

Further detail is provided on this in an upcoming report - *Responding to your comments on Treasury reports on performance reporting [T2024/961]*.

Fiscal Responsibility and Public Sector Management

27. s9(2)(f)(iv)

28.

29.

Next Steps

30. Following your decisions, the Treasury will work towards policy development of the options to provide you with final advice on the PFA amendments by s9(2)(f)(iv). We will keep your Office updated as we develop our thinking on the issues as the year progresses.

31. The table below reflects the indicative timeline for the Bill. s9(2)(f)(iv)

Indicative timeline for the Bill *

No.	Key Milestones	s9(2)(f)(iv)
1.	Treasury Report on scope of the Bill to the Minister	
2.	Policy development of the options for amendments within scope	
3.	Final policy advice on PFA amendments	
4.	Indicative deadline for Cabinet approval of policy changes	
5.	Indicative deadline for drafting instructions to be shared with the Parliamentary Counsel Office	
6.	Date requested for introduction of the Bill to Parliament	
7.	Date of enactment	
8.	Date of commencement	

s9(2)(f)(iv)

Recommended Action

We recommend that you:

- a **note** that the Public Finance Act supports the Public Finance System in three ways – Fiscal Responsibility, Public Accountability & Performance Reporting, and Public Sector Management – but that there are challenges with each of these.
- b **note** that the Public Finance Act is significant, complex legislation, and generally operates well, meaning amendments should be carefully considered.
- c **note** that improvements to fiscal responsibility can largely be achieved within existing legislation (for example, via the Fiscal Sustainability Programme) but that legislative change can bolster this work.

- d **agree** that the Public Finance Amendment Bill should focus on s9(2)(f)(iv)

Agree/disagree.

- e **direct** the Treasury to provide advice on the following proposals

	s9(2)(f)(iv)	Include
a.		Agree/disagree
b.		Agree/disagree
c.		Agree/disagree
d.		Agree/disagree
e.		Agree/disagree
f.		Agree/disagree
i.		Agree/disagree

- f **direct** the Treasury to provide advice on s9(2)(f)(iv) in the Public Finance Act if you are interested in pursuing changes.

Agree/disagree.

- g **direct** the Treasury to provide advice on s9(2)(f)(iv) in the Public Finance Act if you are interested in pursuing changes.

Agree/disagree.

- h **note** that the proposed Parliamentary Inquiry into performance reporting could include recommendations to amend the Public Finance Act.

- i **note** that legislative change to resolve the deeper challenges of the Public Finance System would be more significant than the Treasury is currently resourced to progress.

- j **agree** that legislative change s9(2)(f)(iv)

Agree/disagree.

- k **indicate** if you wish to discuss this report with the Treasury officials at the next available Weekly Agency Meeting.


Agree/disagree.

Tom Hall
Manager, Public Finance Policy

Hon Nicola Willis
Minister of Finance

_____/_____/_____

s9(2)(f)(iv)





Treasury Report: Responses to FEC post-hearing questions for the 2024/25 Estimates of Appropriations

Date:	23 July 2024	Report No:	T2024/1959
		File Number:	MG-3-1-6-2024

Action sought

	Action sought	Deadline
Hon Nicola Willis Minister of Finance	Provide feedback on the proposed responses to the FEC post-hearing questions for the 2024/25 Estimates of Appropriations.	None

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact	
Brendan McBryde	Team Leader, Governance and Accountability	s9(2)(k)	N/A (mob)	✓
Reubhan Swann	Manager, Office of the Secretary, Governance and Accountability		N/A (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Treasury Report: Responses to FEC pre-hearing questions for the 2024/25 Estimates of Appropriations

Executive Summary

This paper provides you with the Treasury's proposed responses to the 2024/25 Estimates of Appropriations post-hearing questions received from the Finance and Expenditure Committee (FEC) on 4 July 2024.

The FEC has submitted 29 post-hearing questions to the Treasury, and we have drafted the responses, attached as Annex 1.

The responses are due with the FEC by 30 July.

Recommended Action

We recommend that you:

- a **Provide feedback** on the enclosed proposed responses to the FEC post-hearing questions for the 2024/25 Estimates of Appropriations.

Reubhan Swann
Manager, Office of the Secretary

Hon Nicola Willis
Minister of Finance

_____/_____/_____

Attachment: 2024/25 Estimates of Appropriations for Vote Finance, is publicly available: https://www.parliament.nz/en/pb/sc/submissions-and-advice/document/54SCFIN_EVI_f7e5942e-ea64-497a-6d2a-08dc80ee0281_FIN2580/responses-to-post-hearing-questions-vote-finance



Reference: T2024/1990 BM-1-2-3-2024-1

Date: 25 July 2024

To: Minister of Finance (Hon Nicola Willis)

Deadline: None
(if any)

Aide Memoire: Fiscal Implications from Public Private Partnerships

We understand that at the Expenditure and Regulatory Review Committee meeting on 23 July 2024 there was some discussion on the fiscal implications from public private partnerships (PPPs). The purpose of this aide memoire is to outline the fiscal implications from PPPs on the Government's key fiscal indicators.

Background

PPPs are arrangements where the private sector is involved in the financing, design, implementation and often the operation of infrastructure projects or services traditionally provided by the public sector. The accounting treatment of PPPs is critical to understand the fiscal implications of these arrangements on the Government's financial statements and key fiscal indicators. The accounting for PPPs in New Zealand is guided by *PBE IPSAS 32 Service Concession Arrangements: Grantor*.

Broadly speaking for financial reporting purposes, an asset (service concession asset) will be recognised by the Government under a PPP arrangement, if it controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price, and the Government controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement.

The Government entered a few PPP arrangements in the 2010's. As at 30 June 2023 the Government's balance sheet includes service concession assets valued at \$5.2 billion from PPP arrangements, with a corresponding financial liability value over these assets of \$3.7 billion.

The accounting treatment can be broken into a construction phase and operational phase.

Construction Phase

In general, through the construction phase the private contractor will be responsible for the design, construction and fit-out of the service concession asset using private finance. With past PPP arrangements the Crown has supplied and continue to own the land under the service concession asset.

During the construction phase the Government “the grantor” would be recognising an asset and a corresponding financial liability on the balance sheet. Table 1 below illustrates the fiscal impacts through the construction phase for the delivery of a service concession asset that will cost \$2.0 billion and be completed by the end of the 2027/28 fiscal year.

Table 1 – Illustrate of the fiscal impacts of PPPs through the construction phase

\$million	2024/25	2025/26	2026/27	2027/28
Asset	500	1,250	1,850	2,000
Liability	500	1,250	1,850	2,000

Operational Phase

Once the construction of the service concession asset is completed it will be depreciated in accordance with the Government’s accounting policies. While the financial liability will gradually reduce over the service concession period.

The grantor will make unitary payments to the contractor which become payable from the date services begin and continue until the end of the service concession period.

The coverage of unitary payments will depend on the nature of the contract but in general will include the following components:

- Compensation for the cost of providing services (including maintenance of the service concession asset) – reported as **operating expenditure**.
Compensation for the costs associated with financing of the service concession asset – reported as an **operating expenditure**.
- Compensation for capital costs (for example, facility and fit-out costs) to be incurred from the operational completion date until the end of the service concession period – reported as **repayment in borrowings** and a reduction in the **financial liability**.

The unitary payment needs to be separated into its various components to enable it to be accounted for appropriately.

Table 2 – Summary of accounting implications during operational phase

<p>Statement of Financial Position</p>	<p>Assets</p> <ul style="list-style-type: none"> • Land (retained on balance sheet) • Facilities and fit-out (including capitalised borrowing costs of the contractor at the time of completion. The assets are depreciated over their economic life) <p>Liabilities</p> <ul style="list-style-type: none"> • Financial liability (amortised over the service concession period)
<p>Statement of Financial Performance</p>	<p>Income</p> <ul style="list-style-type: none"> • Nil <p>Expenditure</p> <ul style="list-style-type: none"> • Cost of service provision by the contractor (recognised as the services are provided) • Depreciation of service concession assets • Finance costs

Comparison to a traditional design-build procurement approach

The accounting entries for PPPs and a traditional design-build procurement approach may differ, but in substance they have very similar implication through the statement of financial performance and statement of financial position. Both approaches result in a recognition of an asset, operating costs from using that asset to provide a service, financing costs from funding the asset and depreciation expense as the asset is used over its useful life.

The key differences between the two approaches are with PPPs there is no cash outlay required upfront as the asset is being constructed and therefore no finance costs are incurred (assuming the Government needs to borrow to fund the asset under a traditional approach) during this period.

As a result, in the short term a PPP procurement approach would have a more beneficial impact on the operating balance before gains and losses (OBEGAL), however this would only be temporary. For departments both procurement approaches would impact on net core Crown debt. However, for Crown entities a design-build

procurement¹ would impact on net core Crown debt, while a PPP arrangement would not impact on net core Crown debt. There is a risk that if a significant amount of PPP arrangements is undertaken by Crown entities this may undermine the credibility of the Government's debt indicator currently used for articulating their fiscal strategy. PPP arrangements by Crown entities will be captured in the previously used headline debt indicator, net debt which is continuing to be published by the Treasury.

Given the accounting treatments are broadly similar, the evaluation of which approach would minimise the impacts on OBEGAL and net core Crown debt would need to be done on a case-by-case basis and will be dependent on the details within the arrangement (e.g. a private contractor may be able to provide services at a cheaper costs than the Crown).

While the accounting treatment for PPPs must follow the relevant accounting standards, Ministers will have choices around the approach to manage the fiscal impacts from PPPs for fiscal management purposes.

Kamlesh Patel, Deputy Chief Government Accountant, Fiscal Reporting, s9(2)(k)

Jayne Winfield, Chief Government Accountant, Fiscal Reporting, s9(2)(k)

¹ This assumes that the Crown would provide the funding to the Crown entity for the construction of the asset, rather than the Crown entity borrowing from the market. This aligns the Government's intention to prevent Crown entities from borrowing from the market as signalled in the 2024 *Budget Policy Statement*.



Reference: T2024/1999

Date: 25 July 2024

To: Minister of Finance (Hon Nicola Willis)

Deadline: None
(if any)

Local government funding and financing tools

At your pre-Cabinet meeting with Treasury officials on 22 July 2024, you requested a briefing setting out the funding tools available to local government, including tools we think that local government could use better, and highlighting any gaps. This was in the context of a discussion where you indicated a preference for new funding tools for local government or greater use of existing tools, in order to reduce funding calls on the Crown.

This aide memoire addresses this commission, beginning with some contextual information about local government, then setting out existing funding tools for local government and relevant Government work programmes currently underway.

This aide memoire also provides a brief description of the Infrastructure Funding and Financing Act 2020 (IFF Act) and current work underway, to provide context for comments made by rating agency S&P Global Ratings (S&P) at your meeting on 19 July.

Local government context

There is significant diversity in council capacity and capability

There is a wide variety of size and circumstance across New Zealand's 78 councils, ranging from Auckland Council which covers a population of 1,715,600 people to the Chatham Islands with 780 people.

The circumstances of individual councils contribute to varying funding and financing challenges across the sector. Some councils are experiencing high population growth, which places pressure on investment to serve a growing population. Other councils have populations that are static or declining, creating funding and financing challenges relating to maintaining existing services with a smaller rating base. Some councils have high levels of tourism with a small permanent resident population, creating pressures for different types and levels of service.


Because of this, we consider it important to consider the appropriateness of funding tools at an individual council level as opposed to taking a 'one size fits all' approach. In some instances, this may involve central government support for council capability. Currently this is provided in a number of ways by central government but could be coordinated and deployed more efficiently.

The role of the Crown in supporting self-sufficiency

Dependency of councils on central decisions needs to be changed to enable and incentivise councils to use their funding tools to the fullest extent. For example:

- Crown legislative changes to funding tools should enable greater use of local government discretion, rather than imposing central government 'gates' or controls on decisions. Recent Cabinet decisions on time of use charging for roading is an example where decision-making on local congestion charging will be controlled by the New Zealand Transport Agency and the Minister of Transport.
- The Government should hold a firm line that local government is responsible for funding its core responsibilities and that Crown funding for these activities will not be forthcoming. Most recently, Crown funding for local responsibilities such as water infrastructure, local roads and flood protection, through mechanisms such as the Infrastructure Acceleration Fund and Infrastructure Reference Group funding, have created expectations of future Crown funding. As a result, councils face dulled incentives to allocate raise revenue levels to fund these projects.

s9(2)(b)(ii)



Revenue

Local authority revenue streams are set on an annual basis. In theory this allows local authorities to deliver according to local needs, however in practice this has led to short-term pressures outweighing long-term infrastructure investment needs. Utility-type regulation (similar to electricity distribution) for local infrastructure assets could be considered to improve asset management and long-term investment.

This type of regulation could be applied to water (drinking and wastewater) and roading infrastructure. Drinking and wastewater infrastructure has existing policy work underway to develop service quality regulation as well as an economic regulatory framework. This may effectively result in revenue regulation as asset owners will be required to raise revenue to meet service standards.

Local government funding tools

Table 1: Current funding tools available to local government¹

Tool	Description
General rates	Rates paid by all ratepayers levied on property values
Uniform annual general charges	A fixed rate paid by all ratepayers
Targeted rates	Rates paid by ratepayers identified as beneficiaries of a specific service, set for a specific period of time
Developer contributions	Charges levied on developers under the LGA to recover the portion of new infrastructure that is related to growth
IFF levy	A multi-year levy (the "Levy") which is paid by beneficiaries of infrastructure projects
User charges	Includes fees and charges, volumetric charging (water), tolls (roads), farebox (public transport)
Commercial opportunities	Includes advertising and sale of useful by-products
Interest and dividends	Many local authorities own (or part own) business enterprises such as ports, airports, forests and farms, or have investments in financial assets such as bonds and shares
Regulatory income	Councils can charge for regulatory services (e.g. building consent and liquor licensing fees)
Crown grants	Grant funding provided by the Crown, for example: National Land Transport Fund for transport, the Provincial Growth Fund, Infrastructure Reference Group 'shovel ready' funding, and tourism funds such as the Tourism Infrastructure Fund.

The Treasury considers that these funding tools are generally fit for purpose and well placed to match up costs with beneficiaries, with the main challenge being that councils do not use these tools to their fullest extent. In our view, the main barrier to councils using these tools ends up being for political economy reasons, such as a general resistance to increasing rates, rather than due to limitations of the tools themselves.

¹ *Funding* refers to how revenue is raised, while *financing* refers to how debt, equity or both is raised for the delivery of a project or service when needed. Local authorities can finance projects on a pay-as-you-go basis (e.g. through current revenue, grants or accumulated savings) or through borrowing.

Funding tools not currently available to local government

Internationally, local governments have a wide range of funding tools including land taxes (rates) that are available to New Zealand local governments, but also a range of local taxes such as local goods and service tax or local income tax. There is also a wide variety of roles and responsibilities for local government internationally, with local governments delivering services not currently the responsibility of local government in New Zealand such as education, healthcare, and policing.

This section describes funding tools currently not available to local government that previous work, such as the Productivity Commission's 2019 inquiry into local government funding and financing, has previously discussed as suitable for local government in New Zealand.

Congestion charging/time of use charging

Time of use charges improve traffic flow by applying a charge at times when demand exceeds road capacity. The charges can vary by time of day and are typically reviewed periodically to avoid flow break-down or free-flow conditions that reduce network efficiency. It is different from road tolling which aimed at recovering road costs.

While the primary objective of time of use charges is to optimise network efficiency through demand management, they can also raise net revenue where the charges are set high enough to offset operational costs. These net revenues could be available to local government.

On 22 July 2024, Cabinet agreed to proceed with enabling legislation for time of use charging schemes [CBC-24-MIN-0072 refers], s9(2)(g)(i)

Bed taxes/accommodation levies

An accommodation levy is a small fee that local authorities can accrue from individuals when paying for a hotel room.

In 2019 a non-binding referendum in Queenstown supported the introduction of a 5% levy being added to short-term room rates. This was considered by the previous Government, but it was not progressed through to Parliament in 2020 as planned due to the COVID-19 pandemic and the closing of the New Zealand borders.

s9(2)(f)(iv)

Value Capture

Value capture has typically focused on direct mechanisms for sharing in value created from changes to land use catalysed by incremental infrastructure development, not already funded by indirect mechanisms (such as general rates).

Relevant legislation that currently provide for value capture mechanisms are the Local Government Act 1974 (LG Act), Urban Development Act 2020 (UD Act) and the IFF Act.

As set out below, the Minister for Infrastructure, supported by Parliamentary Under-Secretary Court, is progressing work on value capture, including consideration of new value capture tools, and improvements to existing tools, as part of his infrastructure funding and financing work programme.

Infrastructure funding and financing work programme

The Minister for Infrastructure has *Improving Infrastructure Funding and Financing* as one of his six key infrastructure priorities. Through the *Going for Housing Growth* and work programme, led by the Ministry of Housing and Urban Development (HUD) this work includes amendments and improvements to local government funding and financing tools including:

- Making enhancements to the Infrastructure Funding and Financing Act,
- Considering whether value capture is best delivered through enhancements to existing tools or through the development of new mechanisms; and
- Considering financial incentives for local authorities to support growth, such as sharing a portion of GST collected on new residential builds.

Infrastructure Funding and Financing Act 2020

Background

The IFF Act provides a way to fund and finance infrastructure projects for urban development. The core of the IFF model involves the setting of a multi-year levy (the “Levy”) which is paid by beneficiaries of infrastructure projects. The Levy is enabled by legislation and levied by a Special Purpose Vehicle (SPV) which is responsible for financing all or part of the infrastructure project and has the power to collect the Levy. To date, the IFF Act has been used for two city-wide infrastructure projects.

S&P’s comments to you that the IFF Act is not as simple as intended. s9(2)(ba)(i)

A MUD essentially functions as an independent, and very, limited type of local government which is managed by a Board elected by property owners/developers. A MUD issue bonds to reimburse developers for providing infrastructure and utilises tax revenues from property owners within the MUD to service and repay the debt.

s9(2)(ba)(i)

[REDACTED] the MUD model was considered as part of the policy development that resulted in the IFF Act and the specific feature of devolving taxation powers to property owners/developers was discounted as not being compatible with New Zealand's local government legislation. The MUD model also requires the United States' sophisticated, and very liquid, debt capital markets to be successful.

Current use and challenges

The slower than expected uptake for city-wide infrastructure projects has been caused by several factors including that IFF Act transactions can be resource and cost intensive for applicants, and that the cost of finance through the IFF Act is higher than through the Local Government Funding Agency (LGFA).

The IFF Act has so far been ineffective for greenfield developments because higher-than-expected potential levies have dissuaded developers from using the Act. This is driven by financiers seeking to charge the same margins for greenfield developments using the Act, as those charged for property development generally. s9(2)(f)(iv)

Current work underway

Legislative reform and operational improvements both offer the opportunity to improve the IFF Act model, reduce costs of IFF Act transactions and support greater uptake.

HUD will provide you and the Minister of Housing a briefing on IFF Act reform in the week beginning 19 August. s9(2)(f)(iv)

Morgan Dryburgh, Acting Manager, National Infrastructure Unit (NIU), s9(2)(g)(ii)



TE TAI ŌHANGA
THE TREASURY

Treasury Report: Kiwibank Competitiveness Considerations

Date:	31 July 2024	Report No:	T2024/1745
		File Number:	CM-1-3-127-3-4-M107278]

Action sought

	Action sought	Deadline
Minister of Finance (Hon Nicola Willis)	s9(2)(b)(ii) and s9(2)(f)(iv) Agree on the potential scope and nature of sources to be considered for raising additional capital for Kiwibank	7 August 2024
Minister for State-Owned Enterprises (Hon Paul Goldsmith)	Note the contents of this report	None
Associate Minister of Finance (Hon Shane Jones)	Note the contents of this report	None

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
David Stanley	Principal Advisor, Commercial and Institutional Performance	s9(2)(k)	s9(2)(g)(ii)	✓
Lars Piepke	Manager, Commercial and Institutional Performance			

Minister's Office actions (if required)

Return the signed report to the Treasury.
--

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Kiwibank Competitiveness Considerations

Executive summary

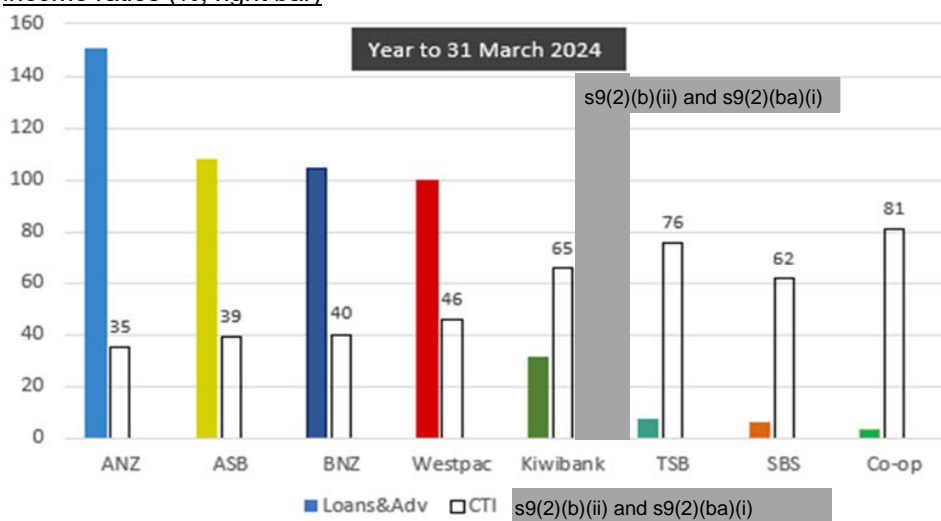
You have requested advice on ways in which the Crown-owned bank, Kiwibank Limited (Kiwibank), can contribute to increased competitiveness in the businesses in which it operates: home lending, personal banking services and business banking ahead of the Commerce Commission’s (ComCom’s) release of its *Market study into personal banking services* (expected on or about 20 August 2024).

In ComCom’s March 2024 interim report it found the sector operates as a stable oligopoly and that Kiwibank has the greatest potential to be a disruptive competitor in the short to medium term. This report provides an initial high-level assessment of what it would take for Kiwibank to have a more substantial impact on market competitiveness.

Kiwibank’s strategy to position itself for more competitive growth

Any bank seeking to undertake substantial business growth first needs the right business platform if the growth is to be commercially sustainable. Without a competitive and scalable platform and cost structure, smaller market participants (including Kiwibank) run considerable business risk should major banks react strongly in the marketplace – thereby undermining smaller competitors’ ability to sustain any competitive drive. The relationship between scale and bank cost structures is shown in figure E1.

Figure E1: Total assets of banks involved in retail banking (\$billions, left bar) and their cost to income ratios (% , right bar)




Note: All banks spend money on Information Technology and business systems improvement, but we only have detailed information for the position at Kiwibank. Therefore, on a like-for-like underlying basis there would be some percentage points reduced from other banks’ Cost to Income (CTI) ratios (but a lesser extent than for Kiwibank)

Kiwibank is now well progressed with a bank-wide transformation programme to improve business systems including a new cloud-based core banking system. If completed successfully, this will provide the platform for more cost-effective growth as scale increases.

Since 2017, Kiwibank has sought to grow its market share in both the retail and business markets (particularly small-to medium sized enterprises (SMEs)) – with the latter targets for substantial growth (from a relatively small base).

As part of its regular business planning processes, Kiwibank prepares scenarios under different business strategies and capital availability settings. Three of these are summarised in figure E2.

s9(2)(b)(ii) and s9(2)(ba)(i)



Options for sourcing capital to support Kiwibank’s growth

The first option for Kiwibank to source the growth capital required is for the Crown to provide all or most of it. To the extent that the Crown does so, it will have to issue additional government debt securities in the market. This will lift net core Crown debt and the allocation of substantial additional Crown funding to Kiwibank may displace another Crown-funded priority policies.

Another approach would be to source new capital from third parties (including Crown Financial Institutions). This means the Crown would be sharing the business risk and earnings of a larger bank with those other parties. So long as the Crown directly or indirectly retains a shareholding sufficient for it to be considered the controlling shareholder¹, Kiwibank would continue to be fully consolidated into the Crown's financial statements.

Capital from third parties could be raised privately from professional investors or from the public through an initial public offering (IPO). s9(2)(ba)(i)

s9(2)(b)(ii) and s9(2)(g)(i)

Next steps

Once you have made your decisions in relation to the matters raised in this report, we will engage with KGC and Kiwibank accordingly. s9(2)(b)(ii) and s9(2)(f)(iv)

s9(2)(b)(ii) and s9(2)(f)(iv)

1 s9(2)(g)(i)

Treasury Report: Kiwibank Competitiveness Considerations

Purpose of Report and Background

1. You have sought advice on ways in which the Crown-owned bank, Kiwibank Limited (Kiwibank), can contribute to increased competitiveness in the businesses in which it operates: home lending, personal banking services and business banking ahead of the Commerce Commission's (ComCom's) release of its *Market study into personal banking services* (expected on or about 20 August 2024).
2. This report outlines Kiwibank's current competitive positioning, some indicative growth scenarios, their potential effect on market competition, risks to be considered, the capital required to support those growth scenarios and its potential sources. This is our first report to you on these topics. We are providing you advice on other ComCom recommendations in a separate Treasury Report (T2024/1842 refers) in early August 2024.
3. We recommend that s9(2)(b)(ii) and s9(2)(f)(iv) [REDACTED]
4. KGC was set up in August 2022 as a Schedule 4A company so the Crown does not need to be the sole provider of Kiwibank's growth capital. s9(2)(b)(ii) and s9(2)(g)(i) [REDACTED]
s9(2)(g)(i) [REDACTED]
5. KGC, Kiwibank and the Treasury are well placed to undertake this work s9(2)(b)(ii) and s9(2)(f)(iv) [REDACTED]
6. s9(2)(ba)(i) and s9(2)(g)(i) [REDACTED]
7. Any matters relating to the capital structure of Kiwibank are commercially sensitive – and have the potential to be considered market sensitive as Kiwibank has market securities (perpetual preference shares and subordinated debt) listed on the NZX and other exchanges, and market sensitive information would need to enter the public domain through the right channels. This will be a matter needing attention alongside any other forward steps.

The Commerce Commission's market study into personal banking services

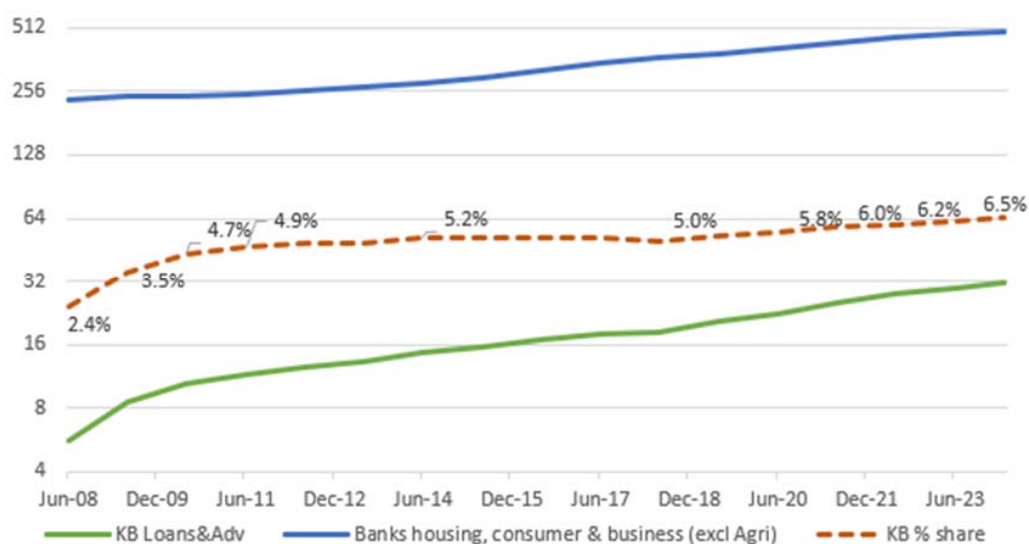
8. ComCom is due to release its final report on 20 August 2024. Amongst ComCom's findings in its March 2024 interim report were that:
- the sector operates as a stable oligopoly. The four largest banks have high and stable market shares and do not face strong competition as there is currently no "maverick" to exert disruptive competitive pressure on them, and
 - there is no single fix to improve competition but smaller banks' access to capital is one of the key constraints affecting the ability of small providers and Kiwibank to grow and compete. As part of this, it considers that the Reserve Bank of New Zealand (RBNZ) should review its new prudential capital settings to take account of competition.
9. ComCom considers Kiwibank has the greatest potential to be a disruptive competitor in the short to medium term. To significantly change Kiwibank's ability to compete, the ComCom considers Kiwibank's owner (KGC and the Crown) should consider increasing its access to capital and support a strategic refocus of Kiwibank's efforts to compete more strongly with the major banks.
10. Kiwibank has stated in its submissions to the ComCom and to Treasury officials that it is prepared to be that "maverick" if requested by its owner. This report provides an initial high-level assessment of what it would take for Kiwibank to have a more substantial impact on market competitiveness.

Kiwibank historical context

11. Now New Zealand's fifth largest bank, Kiwibank was established in 2001 to be a New Zealand-owned bank that could compete effectively with the four largest Australian-owned banks. Initially Kiwibank operated out of original owner New Zealand Post Limited's (NZ Post's) retail outlets, but from 2015 the two companies began to separate operationally. Around the same time Kiwibank also sought to upgrade its core banking systems, but this was only partly successful s9(2)(b)(ii) and s9(2)(ba)(i)
- Kiwibank's large number of branches relative to its size and outdated systems contributed to it having a much higher cost structure and less operational flexibility than its bigger rivals. Major changes have since been implemented including:
- a largely new leadership team, reorganisation of Kiwibank's operations and systems following the appointment of a new CEO (Steve Jurkovich) in 2018
 - extensive evaluation and then implementation of a programme to improve business systems including a new cloud-based core banking system s9(2)(b)(ii) and s9(2)(ba)(i)
- The modernisation programme began in 2019 s9(2)(b)(ii) and s9(2)(ba)(i) If successful, this will provide the platform for more cost-effective growth as scale increases. Kiwibank's operating costs are elevated during the transformation but are expected to decline s9(2)(b)(ii) and s9(2)(ba)(i) Kiwibank transitions to a lower cost and more flexible operating model.

- a repositioning and slimming down of the nationwide branch network to better match customer utilisation with an increasing focus on digital service channels, and
- changing the ownership arrangements for Kiwibank’s holding company (KGC, which acquired and amalgamated with Kiwi Group Holdings Limited (KGH)) to better support the bank’s ongoing growth. In 2017, two Crown Financial Institutions (New Zealand Superannuation Fund (NZSF) and Accident Compensation Corporation (ACC)) became 25% and 22% shareholders, respectively, alongside NZ Post (53%) bringing professional investor disciplines and greater access to capital to the holding company. However, the relatively complex ownership arrangements didn’t work as well as initially hoped, and following discussions with shareholders, the Crown acquired 100% of Kiwibank through KGC in late 2022.

Figure 1: Kiwibank and total registered bank loans (\$ billions); Kiwibank market share (%) (to 31 December 2023)

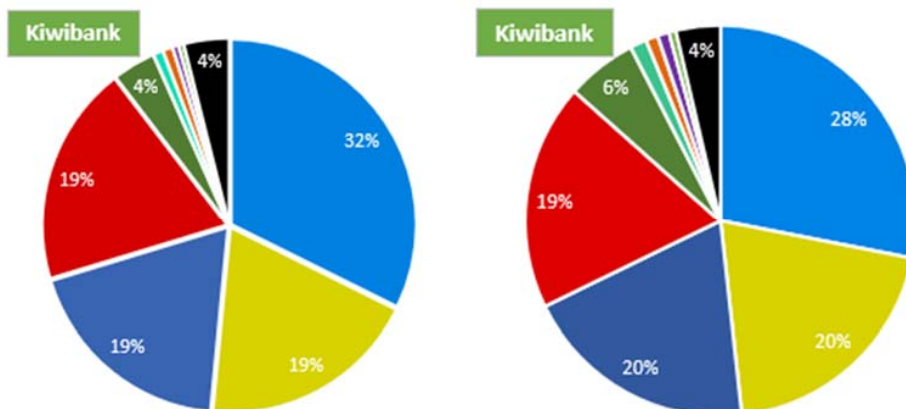


12. Throughout its life, Kiwibank has gained market share, rising from 2.4% of loans and advances to retail customers and businesses (excluding the agricultural sector) in June 2008 to 6.47% currently.²
13. At 6.47% of overall lending, Kiwibank’s market share is still well below that for the four major banks. Since March 2011, Kiwibank may have increased its market share by around 50%, but for the overall marketplace that is a relatively small change. Apart from a 4% decline in the largest bank ANZ’s market share – s9(2)(g)(i) – the overall market doesn’t look that different today to 13 years ago.³

2 We have excluded agricultural lending from this analysis as it is not a market that Kiwibank operates in. Agricultural businesses are subject to international commodities market cycles and lending to the sector requires specific expertise (including industry specific risk mitigation strategies) that are not part of Kiwibank’s core competencies.

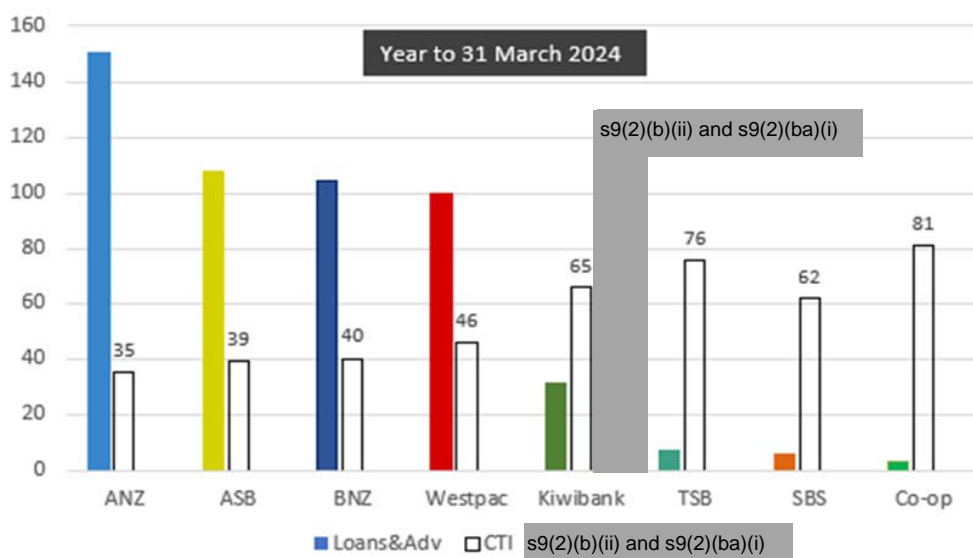
3 s9(2)(g)(i) in 2012 it retired the National Bank brand which likely prompted some customer movement (that bank having been acquired by ANZ in 2003).

Figure 2: Market share of loans and advances - March 2011 (left) and March 2024 (right)



14. The view of limited dynamism in the marketplace is supported by Verian and ComCom’s February 2024 banking customer study that found that 54% of New Zealanders have never switched banks and 85% haven’t switched providers in the last three years. The study also found that only 15% have switched at least one product (but not necessarily switched banks completely) in the last three years and that two thirds have a relationship with only one provider. This is consistent with Kiwibank’s advice that around 4% of customers switch banks each year. Overall, this suggests a marketplace that may be competitive (as the major banks state) but if so, it appears to be a relatively cosy degree of competitiveness – or an oligopoly as ComCom suggests.

Figure 3: Total lending of banks involved in retail banking (\$billions, left bar) and their cost to income ratios (% , right bar)



Note: Most banks spend money on IT and business systems improvement, but we only have access to detailed information for the position at Kiwibank, so a like-for-like underlying cost basis would see some percentage points reduced from bank CTIs (but to a lesser extent than for Kiwibank)

- 15. Smaller banks (including Kiwibank) have historically been disadvantaged by their lack of scale, as operating costs (as measured by the cost to income (CTI) ratio generally appear to have a strong inverse correlation with size. With improvements in technology there is scope for smaller banks to invest in cloud-based systems (as Kiwibank is doing) but the smaller the bank, the higher the relative up-front cost to undertake this work.
- 16. Overall Kiwibank appears to be the only bank that will be well positioned to be able to scale up within a few years, see its operating cost ratios benefit from that scaling and more actively compete with the four largest banks in its chosen markets. Going forward,

there may also be new technology financial services companies (Fintechs) entering the market. Overseas evidence suggests this may take some time and those that are reasonably successful are likely to be targeted for acquisition by larger traditional banks.

17. Whenever a bank has a higher cost structure than the largest market participants and less scalable systems, it is very difficult (and potentially commercially ruinous) to try to compete primarily on price. Lower returns on equity (ROEs) are compounded by any competitive response which slashes financial reserves and thereby the ability of the smaller competitor to grow and more substantially influence the market. Currently, none of the New Zealand-owned banks would be able to sustain a price-leading strategy in retail banking over a long timeframe.

Kiwibank’s competitive positioning

18. Kiwibank remains true to its original vision of challenging the status quo – s9(2)(ba)(i) [redacted]
[redacted] The bank’s current aspirations and strategic direction are summarised in figure 4.

Figure 4: Kiwibank’s aspirations and strategic direction

	Strategic Goals	This means:	Outcomes demonstrating this:
1	Kiwibank (KB) exists to improve banking sector competition in commercially sustainable way	Challenging sector to increase level of competition & deliver better outcomes for customers	s9(2)(b)(ii) and s9(2)(f)(iv) [redacted] Measures: brand meaningfulness customer bank switching KB market share growth
2	Through this NZers become better off both as customers & indirect owners	s9(2)(b)(ii) and s9(2)(f)(iv)	s9(2)(b)(ii) and s9(2)(f)(iv) [redacted] Measures: customer satisfaction surveys s9(2)(ba)(i) [redacted] KB risk adjusted returns & value over time
3	KB’s purpose: <i>Kiwi making Kiwi better off</i>	KB seeks to deliver positive impact for NZ overall	<ul style="list-style-type: none"> • Helping more NZers take control of their financial futures • Leading with a positive community impact as a B-Corp

s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]


19. Kiwibank is currently developing the systems it needs to achieve its goals. Transformation programme milestones so far include:
 - the implementation of modern telephony and workflow systems enabling better customer care and operational efficiency
 - s9(2)(ba)(i) and s9(2)(i) [redacted]
 - overhaul of payment systems to be more cost effective and adding advanced features such as Google and Apple pay.
20. The programme still has several critical steps that still need to be navigated successfully.
s9(2)(ba)(i) [redacted]

s9(2)(ba)(i)

21. Once Kiwibank's current transformation programme (or at least the critical parts of it) are successfully bedded in, significant shifts in the scope of business activities and customer offerings can be efficiently and effectively achieved.

s9(2)(b)(ii) and s9(2)(ba)(i)

s9(2)(b)(ii) and s9(2)(ba)(i)



s9(2)(b)(ii) and s9(2)(ba)(i)

Risk considerations

27. s9(2)(g)(i)

28. If the marketplace does become much more competitive, then there is a risk that profitability is lower and/or costs are higher – and that the value of the business is lower, meaning any new capital raised represents a relatively greater portion of total capital on issue.

29. As Kiwibank grows it will become more important to the overall financial system – just as the big four banks are currently. This presents both a risk and a potential benefit. It is a risk that the Crown is both the owner of the regulator and a systemically important bank – a matter that would likely be increasingly complex in difficult business conditions or a divergence of interests between banker and regulator. However, it also represents a benefit in that for so long as Kiwibank remains well managed, it could be able to continue lending to its chosen sectors throughout the business cycle s9(2)(g)(i)

Role of Kiwi Group Capital (KGC) including its ownership purpose


30. KGC holds the Crown's interests in Kiwibank and the New Zealand Home Loan Company Limited (NZHL) and has the objective of delivering on the Government's objectives for these subsidiaries by overseeing their business strategies and considering their capital requirements.

31. For Kiwibank, the KGC objectives set by the last government are for the bank be a wholly New Zealand owned, and majority Crown owned, commercially successful challenger of the status quo in its chosen markets. Kiwibank, in turn, seeks to be a competitive alternative for New Zealand banking customers while growing on a commercially sustainable basis.

32. s9(2)(f)(iv)

33. KGC is well positioned to consider the merits of, and options for, capital raising and does so periodically. KGC would engage with Kiwibank in the development of any plan for future capital raising and with the Treasury on any advice in relation this.

s9(2)(f)(iv)




Capital raising options

37. We outline the three broad categories of options for sourcing capital to support Kiwibank's growth below, along with some Crown financial statements considerations of each capital sourcing option.

I. The Crown

38. To the extent that the Crown injects additional capital into Kiwibank it will need to source those funds by:
- issuing additional government debt securities in the market lifting net core Crown debt, and/or
 - displacing other Crown-funded priority policies.

39. s9(2)(g)(i)
- 

II. Third Party Professional Investors (including Crown Financial Institutions)

40. Growth capital could be sourced from third parties (including the investable funds of Crown Financial Institutions). This would mean the central Crown would share the business risk (of a larger bank) with those other parties and would also share the

earnings – and if the other parties are non-Crown entities this would be recognised as minority interests in the Crown’s consolidated financial statements. So long as profitability is similar to, or better than, that prior to any capital raisings, the impact on Operating Balance before Gains and Losses (OBEGAL) should be neutral to positive. There would be no impact on the Crown’s net core Crown debt as the Crown would not be raising any additional government debt (Kiwibank’s borrowings are not included in that calculation).⁴

41. s9(2)(g)(i)

III. Initial Public Offering

42. For a bank which has New Zealand ownership as its point of difference, the natural progression for Kiwibank in raising capital in the medium term is through an IPO. This would offer a broader ownership directly than would private capital raising and would remove some of the challenges that arise for illiquid investments (higher return on investment required by investors, greater involvement in governance, more complicated exit provisions etc.).

43. s9(2)(g)(i)

Minimum shareholding level the Crown needs to hold for Kiwibank to continue to be fully consolidated into the Crown financial statements


44. So long as the Crown directly or indirectly retains a shareholding sufficient for it to be considered the controlling shareholder (s9(2)(g)(i)), Kiwibank would continue to be fully consolidated into the Crown’s financial statements.⁵ A non-controlling shareholding would need to be accounted for using the equity method (sometimes referred to as “one-line consolidation”). This would be a more complex set of changes but as it appears unlikely to arise in the foreseeable future, we do not dwell on it further in this report.

4 We note that these observations are based on the issuance of ordinary capital in KGC or Kiwibank. The accounting treatment differs for other forms of capital such as perpetual preference shares and capital notes.

s9(2)(g)(i)

5

s9(2)(ba)(i) and s9(2)(g)(i)



s9(2)(ba)(i) and s9(2)(g)(i)

Engagement with KGC, Kiwibank and other agencies

- 50. In preparing this report, the Treasury has engaged extensively with KGC and Kiwibank and they were both able to review and provide input before content was finalised.
- 51. We have not engaged with the banking regulator (RBNZ) or other government agencies such as the Ministry of Business, Innovation & Employment (MBIE) given the commercial sensitivity of the information and views this report contains, their conceptual and conditional nature and the early stage in any decision-making process (were Ministers to commission further work in this area).

Implementation and next steps

- 52. s9(2)(ba)(i) . However, KGC, Kiwibank and the Treasury all recognise this may be a priority area for the government given its emphasis on improving the levers for New Zealand’s economic growth, responding to the likely recommendations in the ComCom market study into retail banking and any recommendations coming out of the Select Committee hearing into banking that is to be undertaken later this year.
- 53. Once you have made your decisions in relation to the matters raised in this report, we will engage with KGC and Kiwibank accordingly. s9(2)(b)(ii) and s9(2)(f)(iv)

54.

Recommended actions

We recommend that the Minister of Finance:

- a **note** that the Commerce Commission’s *Market study into competition in the retail banking sector* is expected to find that:
 - the personal banking services sector operates as a stable oligopoly and there is currently no “maverick” to exert disruptive competitive pressure, and
 - Kiwibank has the greatest potential to be a disruptive competitor in the short to medium term but would need greater access to capital if it is to significantly challenge the status quo or disrupt the sector.

b s9(2)(b)(ii) and s9(2)(f)(iv)

c



- d **agree** that the plan for KGC to raise additional capital for Kiwibank includes consideration of both the private market and an initial public offering s9(2)(b)(ii)

Agree/disagree.

Minister of Finance

Lars Piepke
Manager, Commercial and Institutional Performance

Hon Nicola Willis
Minister of Finance

____ / ____ / ____

Hon Paul Goldsmith
Minister for State Owned Enterprises

____ / ____ / ____

Hon Shane Jones
Associate Minister of Finance

____ / ____ / ____

Annex 1: Regulatory capital, changing capital requirements and risk weightings

Classes of bank capital and RBNZ requirements

The Reserve Bank of New Zealand (RBNZ) provides that there are three classes of regulatory capital that determine a registered bank's resilience including the ability to absorb losses:

- **Common Equity Capital – Tier 1 (CET1):** This is mainly made up of ordinary shares and retained earnings. It only has a residual claim on a bank's assets in a liquidation.
- **Alternative Tier 1 Capital (AT1):** These are financial instruments that are not common equity but are eligible to be classified as equity. They are usually hybrid securities with perpetual terms. They can be converted into equity when a trigger event occurs. They rank ahead of CET1 Capital.
- **Tier 2 Capital** usually consist of hybrid capital instruments and subordinated term debt. Revaluation reserves on the balance sheet may be recognised as Tier 2 Capital. Subordinated term debt is the most common form of Tier 2 Capital. This debt is subordinated to all other general liabilities but ranks ahead of Tier 1 Capital.

The RBNZ has increased its minimum regulatory capital requirements for registered banks. These requirements continue to rise over the next few years as shown in Figure A1.1. Currently Kiwibank is not regarded as systemically important to the domestic financial system. However, were it to significantly grow its market share, there will come a time when it would likely be so designated.

Figure A1.1: RBNZ capital requirements

	Minimum RBNZ requirement as from				
	1 July 2024	1 July 2025	1 July 2026	1 July 2027	1 July 2028
Core Equity Tier One Capital (CET1)	4.5%	4.5%	4.5%	4.5%	4.5%
Plus Additional Tier 1 (AT1) and Tier 2 Capital					
Equals Total Capital	9.0%	9.0%	9.0%	9.0%	9.0%
Plus Conservation buffer	2.5%	3.5%	4.5%	5.5%	5.5%
Plus Countercyclical buffer	0%	0%	0%	0%	1.5%
Total capital requirement for non D-SIBs*	11.5%	12.5%	13.5%	14.5%	16%
Plus D-SIB buffer	2%	2%	2%	2%	2%
Total capital requirement for D-SIBs	13.5%	14.5%	15.5%	16.5%	18%

*Domestic Systemically Important Banks (DSIBs) – ANZ, ASB, BNZ and Westpac

All the additional buffers are to be held in the form of CET1 capital.

Figure A1.2: Kiwibank capital position as at 31 December 2023 (latest disclosure statement)

	RBNZ requirements as at Dec 2023	December 2023 %	December 2023 \$million
Core Equity Tier One Capital (CET1)	4.5%	11.9%	2,168
Plus Additional Tier 1 (AT1) – Perpetual Preference Shares		1.4%	246
Equals Total Tier 1 Capital	6.0%	13.3%	2,414
Plus Tier 2 Capital – subordinated notes		2.6%	471
Equals Total Capital	8.0%	15.9%	2,885
Plus Conservation buffer	2.5%		
Plus Countercyclical buffer	0%		
Total capital including buffers	10.5%	15.9%	2,885

s9(2)(b)(ii) and s9(2)(ba)(i)

Risk weightings of assets

Standardised approach

Banks' capital requirements are based on the perceived riskiness of the assets on and off their balance sheets. The RBNZ specifies risk weights to be applied to the different classes of assets. For example, cash is perceived to be virtually risk free and has a zero-risk weight. Residential mortgages are perceived to be relatively safe and the RBNZ generally requires a 35% risk weight to be applied to these assets, while commercial loans are considered risky and therefore generally receive a risk weight of 100%. Similar methodology is applied to off-balance sheet items. In addition, banks are also required to calculate their implied risk-weighted exposures on their market and operational risks.

Total risk-weighted assets derived from the above calculations are then divided by the different groups of capitals to arrive at the capital ratios.

This approach is used by all New Zealand incorporated banks except the D-SIBs.

Internal Rating Based (IRB) approach

The Domestic Systemically Important Banks (D-SIBs) are accredited to use risk-weightings calculated based on their own internal models on credit and operational risks and this regulator-approved approach is one to which the ComCom report refers in terms of relative competitive disadvantage for Kiwibank and smaller banks.

The risk weightings in internal models are generally lower than the standardised approach which other banks are required to use. They are based on the bank's own loss history and the notion that these large banks have the sophisticated risk management systems and resources to manage and control these risks.

Based on the banks' disclosure statements, risk weights⁶ for residential mortgages of the D-SIBs ranged from 20% to 34%, while Kiwibank was 37% and the smaller New Zealand banks also had higher risk weights than the D-SIBs.


Risk weights for D-SIBs corporate business ranged from 58% to 62%, compared to Kiwibank's 93% - although the business mix tends to be quite different as Kiwibank is principally lending to SMEs.

Since January 2022, banks accredited to use the IRB approach are subject to an 'output floor'. This means their estimates of risk-weighted assets (RWA) will either be the outcome of their IRB models, or 85% of the standardised outcome, whichever is highest.


s9(2)(g)(i)

⁶ Note that some caution should be used in directly comparing different banks and so the figures used here are for illustrative purposes only. The banks' average risk weights are affected by the mix of their exposures and no bank has exactly the same lending and risk mix.

s9(2)(g)(i)



s9(2)(g)(i)



We note that introducing any third-party shareholders into Kiwibank or KGC – or should an IPO be considered, the collective arrangements – will need to be approved by the RBNZ as bank regulator. There will also be some important considerations relating to governance to be worked through, but these can be initiated at the appropriate time during preparation.