



9 February 2018

Catherine Savage
Chair
Guardians of New Zealand Superannuation
PO Box 106607
AUCKLAND 1143

Dear Catherine

ANNUAL LETTER OF EXPECTATIONS

I am writing to convey my expectations of the Guardians of New Zealand Superannuation (Guardians) as it executes its business planning process for the forthcoming year.

Expectations for All Crown Financial Institutions

Performance

- *Long-Term Performance:* A prime focus for Ministers is that the Crown Financial Institutions (CFIs) achieve their long term performance objectives. The Crown has a long term perspective on returns, and acknowledges that returns will vary from year to year, sometimes due to temporary or non-controllable factors. Emphasis will continue to be placed on longer term returns. In circumstances where the longer term return is persistently below the performance objective, I expect the entity to review the appropriateness of its investment strategy. Furthermore, where active management or other value adding strategies are employed, achieving returns in excess of benchmarks after investment management fees and other operational costs is expected.
- *Investment Management Expenses:* Notwithstanding the expectation for CFIs to outperform investment objectives after investment management costs, each CFI should also ensure that the costs incurred in implementing its investment strategy are appropriate in the context of managing Crown assets. I expect that you will ensure full transparency of both external and internal investment management costs, particularly performance fees, and that you will ensure that internal performance incentives are aligned with the entity's objectives.

Risk Management

- *Risk Profile:* In the past, particular emphasis has been placed on the CFI's financial returns performance. I expect to see a greater emphasis on the risk-adjusted performance of your entity in order to better reflect the investment strategies that are employed to deliver these returns. Furthermore, I expect to be consulted if you are pursuing any strategic changes that may materially alter the risk profile of your entity. I also ask that you ensure that appropriate emphasis is placed both on quantifiable investment risk as well as the more qualitative non-market risks that are inherent in investment management activity.
- *Complex Products and Activities:* The aggregate funds managed within the CFI portfolio continue to grow as a percentage of the Crown's balance sheet. Within this portfolio there has been an increase in the complexity of the investment activity being undertaken, including an increase in the use of derivative instruments. Consistent with expectations in previous years, it is my expectation that CFIs should use derivatives judiciously and that, where relevant, a strong case is made for their use relative to physical exposures. I expect transparency in the reporting of your derivative use and the way in which you measure and determine it to be 'judicious'. Furthermore, I expect that the CFIs will regularly assess the use of derivative instruments and the extent to which other complex investment activity is undertaken, particularly as market conditions and practices evolve, to ensure alignment with your legislative framework, including any specific approvals that have previously been issued from my office.

Relationship with the Crown

- *Flow of Information:* Of growing importance for the Crown is the need for adequate independent analysis of financial and other investment risks at an aggregate level across the CFI portfolio and, to a certain extent, across the broader Crown balance sheet. As such, the Crown is focused on establishing a deeper and more frequent flow of information from the CFIs to the Treasury. I expect all CFIs to support the Treasury in fulfilling the Crown's information requirements by providing all requested information and any additional resource that is needed to facilitate this strategy. I anticipate that the first phase of data collection and initial analysis will be completed within this fiscal year, however, ongoing compliance with the Crown's information requirements will be required in 2018/19 and beyond.
- *Board Relationship:* I consider it to be critical for the good stewardship of the CFIs that an open and effective dialogue is maintained between each CFI's Board and the Treasury. This should span all areas of potential shareholder interest, from strategic direction through to material operational matters, and it is my expectation that the relationships extend across the whole of the Board.
- *'No Surprises' Policy:* I expect you to maintain a 'no surprises' policy and to inform me well in advance of any material or significant events, transactions and other issues that could be considered contentious or attract wide public interest, whether positive or negative.

Ethical Investment

- *Policy Review:* It is important to this Government that each of the CFIs maintains robust ethical investment policies. You have formulated a policy as part of your investment framework with alignment to your statutory mandate. My expectation is that you will regularly review and, where appropriate, update this policy to reflect both international and domestic progress in ethical investment practice.

Expectations Specific to the Guardians

- *Policy Matters:* I recognise that there are certain policy decisions which may be taken by the Crown that have an impact on the Fund, particularly when it comes to decisions around fiscal management and what those decisions may mean in terms of contributions to the Fund. I note that such decisions are ultimately the right and responsibility of the Crown, and as such, I encourage you to direct any commentary and observations on such matters to me and / or the Treasury, where you deem such engagement to be consistent with your role as the Crown's agent.
- *Information Requirements:* I am aware that the Guardians has raised concerns about the Treasury's CFI Information Strategy. The Treasury's requirement for enhanced CFI data flow and its independent aggregation and analysis is entirely consistent with my expectations of the level of oversight that the Treasury should have as monitor of the CFIs. It will also allow for better informed fiscal decisions. As such, I expect you to meet the requests from the Treasury for information relating to this programme. I understand that the Treasury will engage with you to ensure that any concerns you may have relating to the security and probable use of the information are addressed.

Engagement

The Treasury is continuing its focus on engaging closely with entities to gain a better understanding of the strategic issues, risks and influences on entities' financial performance. In light of this continued emphasis on close engagement, I would like the Board to meet with the Treasury to discuss this Letter of Expectations at an appropriate time.

If you have any questions or require further clarification on any of my expectations, please contact Grant Cotty at the Treasury on 04 890 7268 in the first instance.

Yours sincerely



Hon Grant Robertson
Minister of Finance

cc: Adrian Orr
Chief Executive
New Zealand Superannuation Fund
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AUCKLAND 1143

Annex 1

Timetable for the Business Planning Process for 2018/19

<i>Due Date</i>	<i>Key Action</i>
28 February	Board sends strategic issues letter to the Minister
February/March	The Treasury to discuss the Letter of Expectations with the Board
1 May	Board submits draft SPE to the Minister and the Treasury
30 June	Board delivers final SPE to the Minister and the Treasury

All entities are expected to provide the Minister with a strategic issues letter by **28 February 2018**, setting out the key strategic issues facing the entity. Should your entity wish to engage with the Minister to seek clarification of expectations, we would ask that you advise the Treasury as early as possible of such intentions.

All entities are expected to provide the Minister with a draft SPE, consistent with the expectations as detailed in this letter, by **1 May 2018**.

The final SPE should be delivered to the Minister on or before **30 June 2018**.

The Minister and the Treasury should be alerted as soon as possible if any of these deadlines cannot be met.