NZSUPERFUND
Te Kaitiaki Tahua Penihana Kaumātua o Aotearoa

Chair
Finance and Expenditure Select Committee
Via email: finance.expenditure@parliament.govt.nz

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Tēnā koe Mr Brewer,

2023/24 Annual Review Post-Hearing Questions – Guardians of New Zealand Superannuation

Thank you for the opportunity to speak with the Finance and Expenditure Committee on 2 May, and to now respond to the Committee's Post-Hearing questions. The questions and our responses are set out below.

The Committee notes the Guardians changes in Executive personnel over the last 18 months, its strategic focus and completing its 20 years of investing as an organisation in the period of review.

1. *With new leadership personnel in place for the Guardians, what can we expect to be different or innovative from the Guardians?*

Successful investing requires a willingness to learn and a commitment to continuous improvement. I don't expect any significant changes to our investment approach, which is designed to suit the requirements of our legislation and to capitalise on our competitive advantages. As our organisation matures and as global best practice evolves and changes, we will continue to refine key elements of that approach, such as the Reference Portfolio benchmark, our sustainability proposition and model, and our use of a Total Portfolio Approach to invest the NZ Super Fund.

We are putting a lot of thought into how to best manage our expected growth. Treasury's current projections are that the size of the NZ Super Fund will more than double between this year and 2038, and double again by 2051. That involves considering how we can retain what has led to our success so far as funds under management continue to grow. For example, we need to ensure that our technology and data strategies, our learning and development platforms, and our succession planning and business continuity models remain relevant and fit for purpose.

2. *What recommendations in the five yearly review are being prioritised first by the Guardians? What shifts are the Guardians expecting to see from 2024/25*?

WTW's report included seven recommendations and five suggestions. We have formally confirmed to the Minister of Finance that we agreed with all of them. Their recommendations regarding change management, proactive staff training and strengthening our technology proposition are incorporated into our refreshed organisational strategy, Guardians of the Future; some technology improvements have recently been rolled out, and more are in train.

WTW's recommendation that we continue to evolve the Total Portfolio Approach model we use to invest the Fund (in particular, their recommendation that we improve the integration of systemic risk and associated tail risk models) is already part of our thinking and planning, and will be included in the upcoming review of the Reference Portfolio.

Work to enhance how we resource insourced investment in private markets is also under way, and we will continue to discuss resourcing for Board fees (and for the Nominating Committee) with Treasury, in order to progress the development of strong leadership succession practices.

WTW's remaining recommendation is that we mature our sustainability proposition and model. We have adopted an organisational purpose statement (sustainable investment delivering strong returns for all New Zealanders) which has sustainability at its heart; and a Sustainable Investment Strategy to which we are fully committed. As WTW noted, however, this is an area in which global best practice is evolving rapidly. We believe we have more work to do to fully consider how to respond to all aspects of this recommendation, including incorporation of universal ownership/3D investing principles and the recommended focus on system stewardship.

3. *With 20 years investing with the Fund, how are the Guardians leveraging its investing experience to shape the next 20 years and to what extent has any lessons learnt specifically informed its strategic focus areas?*

Our commercial mandate, operational independence and long investment horizon enable us to take a growth-oriented investment approach to investing the Fund. Maintaining this relatively high-risk approach (compared to peer funds) through time and during market volatility requires stakeholder support and strong governance. It also requires expert staff who feel supported to take investment risk knowing that while not all individual investments or strategies will be successful, overall portfolio risk is prudently managed.

We use a risk budgeting method to invest the Fund. Our approach allows for considerable flexibility in how we allocate risk. Risk budgets describe the expected allocation of risk over time; however, point-in-time allocations can vary a lot. This is in line with our adoption of a Total Portfolio Approach to investing the Fund and allows us to take advantage of the most attractive investment opportunities as they arise.

Conducting our first organisational culture survey in 2011 led us to consider the gap between the workplace culture we had and the ideal culture as we had defined it. Since then, we have made steady progress towards that ideal. Our organisational culture (in which constructive challenge is key) and strong employee value proposition have greatly helped us to attract and retain high-quality staff. As the Fund continues to grow, maintaining that strong culture and employee value proposition will be crucial to our continued success.

4. *The Guardians have conveyed the systemic challenges and risks facing their future performance. Please expand on what these challenges mean for the Guardians. What are the Guardians' doing to mitigate or address these significant challenges and risks to its future performance in the near term and the longer term?*

One of our fundamental investment beliefs is that prices tend to revert to fair value over time – and we need to recognise that philosophy applies to our own performance as well. Our expectation is that over a 20-year period the Reference Portfolio (a notional, index-linked portfolio that is our main performance benchmark) will return 6.8 percent per annum and that our Actual Portfolio will outperform that by one percent per year. Over the 20 years to 30 June 2024, the Reference Portfolio returned 8.49 per cent per annum and the Actual Portfolio outperformed that by 1.54 percent per annum.

We need to be honest enough and humble enough to recognise the part market conditions have had to play in generating what has been an outstanding result.

As noted above, we believe a growth-focused, diversified portfolio remains the right approach for our mandate and our purpose, and offers us the best opportunities to capitalise on our endowments, irrespective of short-term market conditions.

That doesn't mean that the strategies that have succeeded in the past will also be right into the future. We regularly test our assumptions regarding long-term risk-adjusted returns for various asset classes, we are about to review the composition of the Reference Portfolio to ensure it reflects an acceptable level of risk, and (as also noted above) we are working on implementing the recommendations WTW made in last year's one-in-five year statutory review.

The Committee notes the Fund's investments in New Zealand private companies.

5. *What will the Fund's $50 million investment achieve for New Zealand companies and by when?*

This investment was into DCVII, a private equity fund managed by New Zealand private company investor Direct Capital, an incumbent manager of NZ Super Fund since 2005. Fundraising for their latest fund, DCVII, was completed in December 2024, with the total fund closing at $525 million, and the fund investment period commenced on 1 April 2025.

Direct Capital invests predominantly in the New Zealand mid-market private company sector in expansion, succession and pre-IPO situations. (Note that New Zealand's mid-market sector in this situation is defined as companies with Enterprise Values of $50 million - $400 million.) DCVII is expected to make between six and 10 investments with equity cheques into each company in the range of $30 million to $110 million. Direct Capital aims for the Fund to be fully invested within five years.

Direct Capital's sixth fund, DCVI, raised $425 million in 2020 including a $80 million commitment from the NZ Super Fund. Direct Capital VI was fully invested into six portfolio companies, including five New Zealand-based entities: Mondiale VGL, Hiway Group, Wet & Forget, Bayleys and Active Refrigeration.

6. *What is the medium to long-term plan for further investment into New Zealand? What are these opportunities and what sectors/industries are the Guardians exploring?*

The Fund's domestic investment strategies have performed well, and we continue to look for fresh opportunities to deploy capital locally. Recently, we have expanded our rural land portfolio, committed further capital to locally managed funds that provide growth capital to New Zealand businesses, and continued to invest in various land development initiatives that will provide platforms for housing and social infrastructure.

We consider several dozen possible domestic transactions annually. We focus on opportunities that are suited to our long investment horizon, where our capital is differentiated, and where we can earn an attractive risk-adjusted return.

Scale is a challenge for identifying domestic investment opportunities that meet our commercial criteria. Like other institutional investors we have a minimum investment threshold, which is very much aligned with cost control and best-practice portfolio management.

We therefore believe that large scale investments in infrastructure, real estate and opportunistic investments in sizeable New Zealand companies (where we see a good fit with our competitive advantages) offer the best opportunities for the Fund to increase the size of its New Zealand investment portfolio.

It is important to note that from time to time the Fund will sell New Zealand investments as well as buy them, as we look to optimise portfolio returns. However, relative to nominal GDP, the value of the Fund's New Zealand assets has increased over the past 15 years.

Factoring in the small size of the New Zealand economy and its listed markets, the Fund deploys a significant proportion of capital domestically (11% of the Fund or $8.4 billion as at 30 June 2024). To give one contextual example, the Fund's 4% investment in NZ listed equities compares to the circa 0.1% that the NZX makes up of global markets.

The Committee notes the Fund's performance in 2023/24.

7. *Whilst investment performance results remain relatively stable, what if any concerns does the Guardians have for future performance results? What measures could be at risk (given also systemic risks and challenges the Guardians have identified)?*

In the short to medium term, it will be extremely challenging for the Fund to continue to outperform at the level it has done over the last 20 years. However, we remain confident of meeting our long-term performance expectations over rolling 20 year periods – a period we consider an appropriate timeframe on which to judge the Fund's success in meeting its mandate. The Fund may well underperform on one or both performance measures (value add / net return) over shorter time periods. It is important stakeholders understand that this is expected.

As noted in our answer to question 4, both the Fund's Reference Portfolio benchmark, and the value added by its active investments on top of that, have exceeded expectations over the past 20 years. Significantly, these returns have been generated at much lower-than-expected levels of risk.

We expect levels of risk to increase over the coming decade. To meet that challenge, over the past five years we have considerably improved our risk budgeting process. We now take a more conservative approach to liquidity management than previously – and incorporate liquidity management considerations into our budgeting of active risk; we allocate risk to investment opportunities (effectively sub-asset classes) rather than to broader categories; and we review our risk budgets more frequently.

8. *For the Guardians 'Organisational Capability' measure, why does the Guardians have not more timely measurement of culture (last result was in 2022), especially with a change in Executive personnel from 2023/24? When will the next Culture Survey be conducted?*

The most recent Culture Survey was completed in July 2024, with results shared with staff in the months following. These results will therefore be covered in our 2024/25 Annual Report. In summary, 234 employees responded to the 2024 survey (a 98 percent response rate). Results reflected a strong, supportive working culture where employees feel respected and valued.

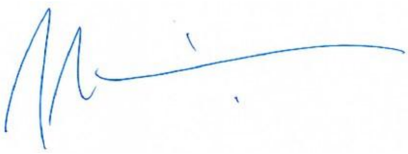
The biennial culture survey is complemented by an ongoing monthly anonymous engagement survey which measures employee engagement, health and wellbeing, diversity equity and inclusion, risk matters, transformation and change, and whether the Guardians is living up to its organisational values.

9. *Similar to previous years, the Guardians have little information on the conviction review of NZGCP in its accountability reporting. Please specify further information and details of the conviction rating of NZGCP being downgraded earlier in the year. What is the outcome of Crown funding for NZGCP?*

The conviction review is an annual process we undertake as part of our governance and oversight role in respect of the Elevate Fund. It assesses the foundation factors which must be present for us to invest through a third party. Reflecting the uncertainty regarding further funding for Elevate, and consequent concerns that we hold around NZGCP's future viability and ability to retain critical staff, we downgraded our conviction rating of NZGCP to 'sub-threshold'. Funding is a decision for the Minister of Finance, not the Guardians; once this decision has been made, we will update our conviction rating. It remains our view that without additional Crown funding Elevate will not be in a position to achieve its statutory purpose and that it is probable that the progress achieved to date in developing New Zealand's venture capital markets would be substantially lost.

Thank you again for your time and please contact us if we can be of further assistance.

Yours sincerely



John Williamson

Chair