TITLE:

Guardians of NZ Superannuation and New Zealand Superannuation Fund

2016-17 Review

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EVENT | PRESENTATION:

Finance & Expenditure Select Committee, 8 February 2018

#2427200

Agenda

- Our role and mandate
- Investment approach
- Benchmarking
- Performance
- Outlook

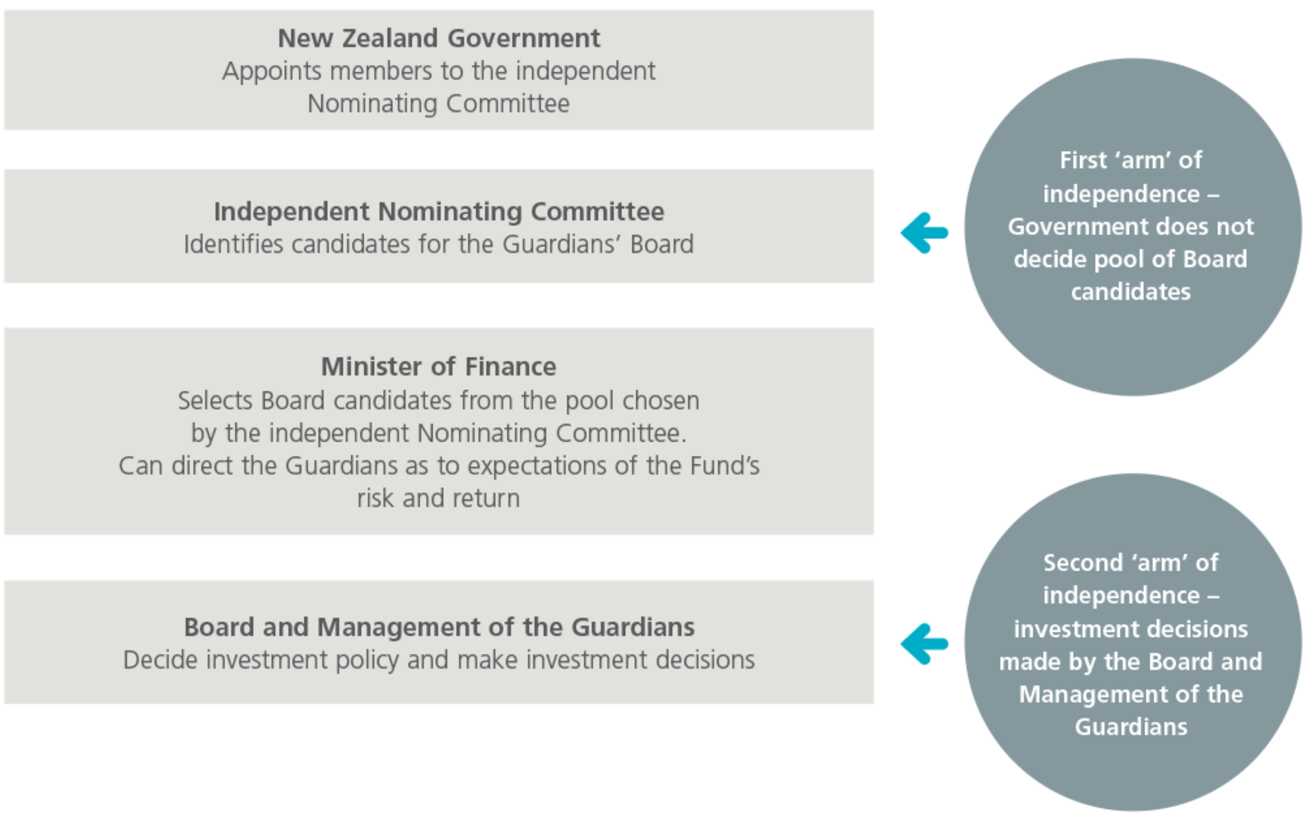
Where we fit in – part prefunding Tier 1

Tier 1 **Tier 2** **Tier 3**

- **The NZ Super Fund is expected to pre-pay approximately 20% of NZ superannuation costs by 2040**
- **Contributions were suspended from July 2009 and restarted in December 2017**

Governance framework

- The Guardians of NZ Superannuation is an autonomous Crown entity, legally separate from the Crown, and operates at double arms' length from Government
- The Guardians manage and administer the Fund. The Fund is the pool of Crown assets



Mandate

- **Mandate** (Act of Parliament):
  - The Guardians must invest the Fund on a prudent, **commercial** basis and must manage it in a manner consistent with:
    - Best-practice portfolio management;
    - **Maximising return without undue risk** to the Fund as a whole; and
    - Avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

Investment approach

We look to utilise the Fund's liquidity profile, long-term investment horizon and governance strength

- We construct a portfolio that balances our highest estimated return with financial risk → the best likelihood of success
  - First capital withdrawals not currently scheduled until 2034-35
  - Strong weighting towards growth assets (because we can ride out short-term volatility)
- Principles and advantages of long-term investment:
  - A clear purpose + long horizon, highly liquid, operationally independent
  - Discipline and capacity to stay the course - governance
  - Transparency and clear communication with stakeholders
  - Focus on best-practice, including environmental, social and governance (ESG) factors

Investing in New Zealand

- Ministerial Directive (2009)
  - "…that opportunities that would enable the Guardians to increase the allocation of New Zealand assets in the Fund should be appropriately **identified** and **considered**…"
  - "This direction is not intended to be inconsistent with the Guardians' duty to invest the Fund on a prudent commercial basis, in accordance with section 58 of the Act, and the above paragraph is subject to that duty."
- As at 31 December 2017, $5.3 billion was invested in New Zealand, 14.6% of Funds Under Management - if the Fund had a passive approach to investing it would hold 0.1% in NZ assets
- The Fund is one of the largest institutional investors in NZ and plays a significant role in NZ's capital markets
- Investments include Kiwibank, Datacom, Kaingaroa Timberlands, Metlifecare, NZ dairy farms, housing, NZ equities and (via external managers) in expansion capital
- Our NZ Direct investment team has set up an Investment Hub to drive domestic deal flow in NZ by leveraging our experience and advantages – this includes working towards partnerships with Māori investment organisations

NZSUPERFUND
Te Kaitiaki Tahua Penihana Kaumātua o Aotearoa

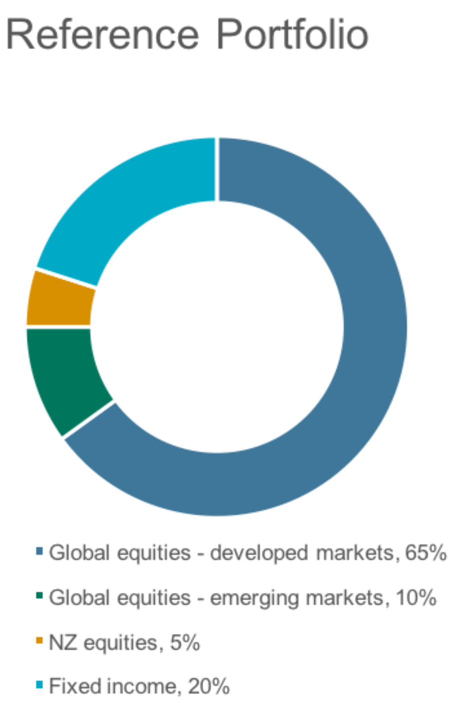
Benchmarks

We benchmark against best practice industry principles, measures and relevant global peer funds

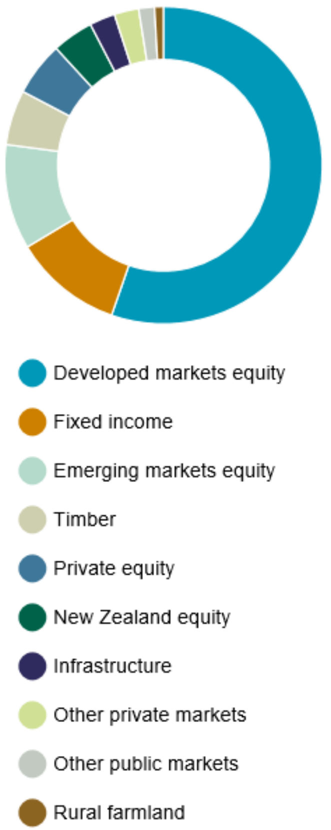
	Internal measures and mechanisms	External measures	Stakeholder engagement
Cost structure	By business unit By investment opportunity Holistic view of fees	CEM Benchmarking Survey Hay remuneration database	Peer fund engagement: • 3Cs: Comparison, collaboration and co-investment Global expertise
Governance	Reference Portfolio Review Internal Audit	Independent Reviews ‘04, ’09, ‘14 OAG special performance audit (‘08) SWF GAAP Select Committee Reviews	
Performance	NZ T Bill rate + 2.7% Reference Portfolio + 1.0%	Performance against both measures published monthly	
Transparency	Website Annual Report OIA	Sovereign Wealth Institute’s Transparency Index	
Responsible Investment		UNPRI assessments	
Risk	Risk Committee Reviews Risk Registers Investment Risk Limits Target Liquidity Level	CEM Benchmarking Survey	

Reference + Active = Actual Portfolio

Growth-oriented portfolio, majority passive, highly diversified



Actual Portfolio as at end December 2017



Performance

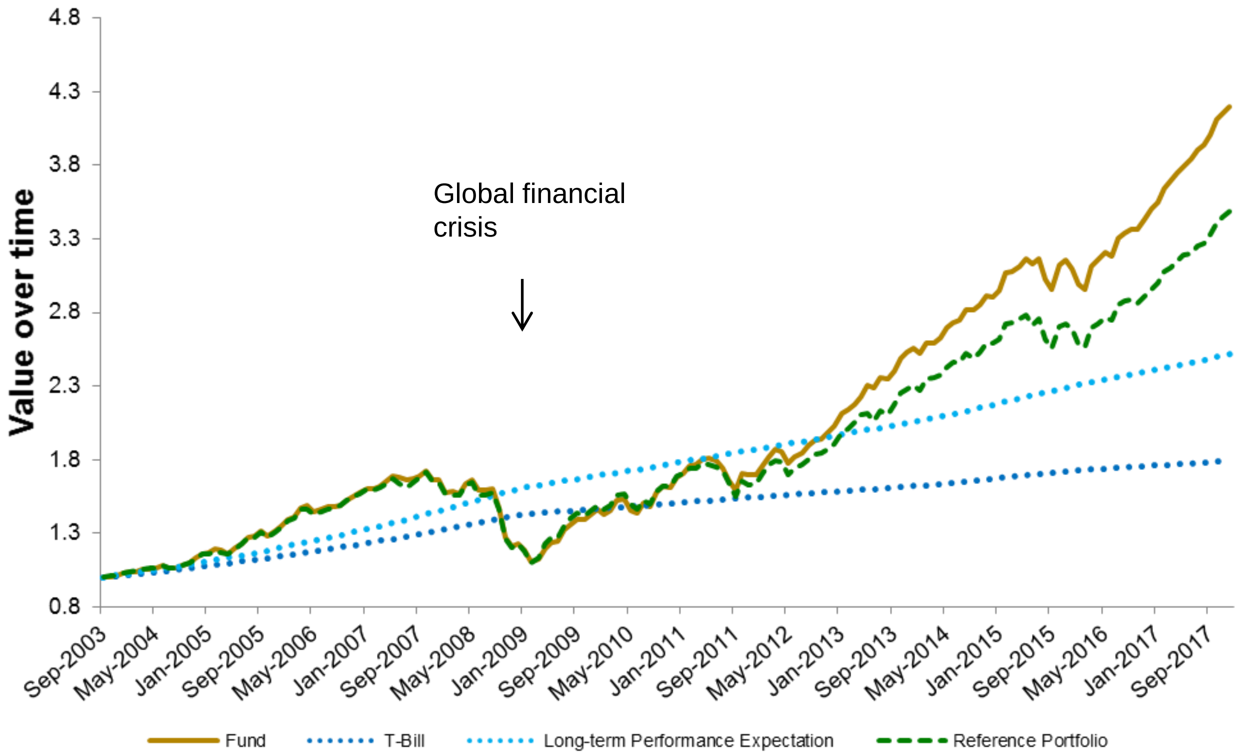
Performance as at 30 December 2017	Last 10 years	Since inception
Contributions received	$3.61 billion	$14.95 billion
Returns (after fees and foreign tax, and before NZ tax)	$25.36 billion	$29.24 billion
NZ tax (paid) / received*	$(4.9) billion	$(6.25) billion
Other movements**	$0.03 billion	$(0.03) billion
Closing Fund balance as at 31 December 2017	**$37.91 billion**	

* Tax ‘received’ covers any instances of refunds for overpayment of tax
** Other movements relate to transactions other than tax paid or received e.g. tax expense, movements in reserves

For the 2017 financial year the Fund was the largest New Zealand taxpayer, paying a record level of New Zealand income tax of $1.2 billion

Performance

This graph shows what has happened to the first dollar invested in the Fund over time.



Exceeded Reference Portfolio by $6.9b (1.43% pa)

Exceeded Treasury Bills by $22.1 b (6.38% pa)

Total Fund Returns $29.2b (10.52% pa)

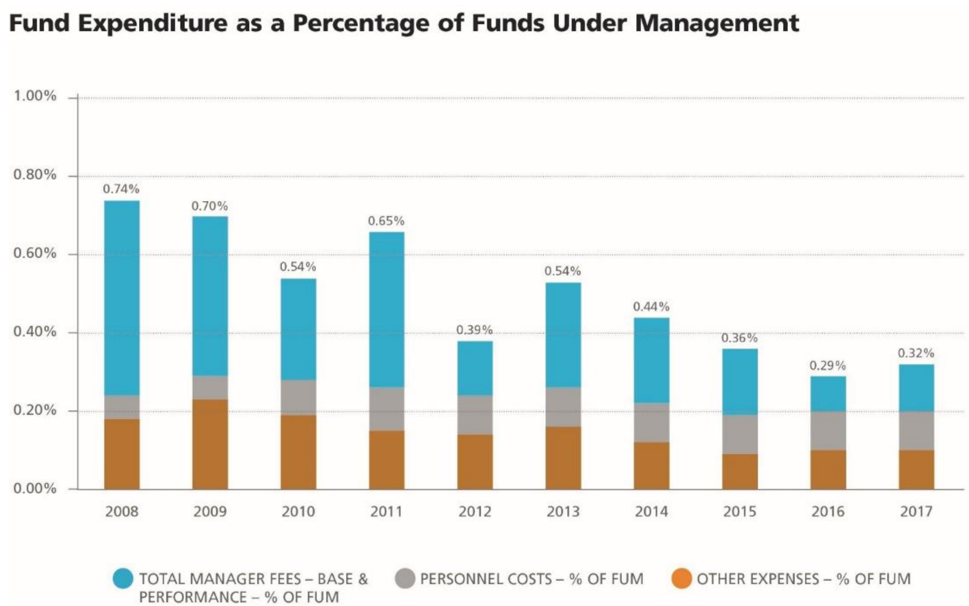
Reference Portfolio return - the best **passive**, listed "market" return that would achieve the Fund's objectives over time

Treasury Bill return - a measure of the cost to the Government of contributing to the Fund instead of paying down debt

Cost

CEM (Cost Effectiveness Management) Benchmarking is the global leader in benchmarking pension and sovereign wealth funds

- CEM's latest report found our net value-add was above the median of our peers and costs were below the median – both for the 12 months to December 2016 and over the five year period
- The Fund's costs as a percentage of assets have reduced over time
- This has been driven by a reduction in manager fees and advisor costs, offset by increased performance fees and personnel costs (in-sourcing decision making)



Global peer engagement

- Systematic programme of engagement with peer funds: Compare, collaborate, co-invest
- Hosted the International Forum of Sovereign Wealth Funds in New Zealand in November 2016
- These activities are designed to mitigate the distance and scale challenges inherent in running a (comparatively small) global investment Fund from New Zealand – ensuring we operate at global best practice standards

ESG integrated into the investment process

Environmental, social and governance factors, including climate change, are integrated into the investment process

As share owners, we manage ESG through collaboration, engagement and, in some cases, exclusions

Our performance on ESG is measured through global benchmarking

Climate change is an investment risk

CLIMATE CHANGE INVESTMENT RISK STRATEGY

GOAL
A portfolio more resilient to climate-related risks.

TARGETS
By 2020: to reduce the carbon emission intensity of the Fund by at least 20%; and reduce the carbon reserves of the Fund by at least 40%.

PRINCIPLES

1 — Whole portfolio
Manage climate risks and opportunities of the whole portfolio.

2 — Consistency
Be as consistent as we can across all investments (listed and unlisted; active and passive).

3 — Best tools
Use the full range of tools available to us. There is no single solution.

WORKSTREAMS

REDUCE
Reduce exposure to fossil fuel reserves and carbon emissions.

ANALYSE
Incorporate climate change into investment analysis and decisions.

ENGAGE
Manage climate risks by being an active owner through voting and engagement.

SEARCH
Actively seek new investment opportunities, for example in renewable energy.

Climate strategy implementation

Reducing passive equities

- As at the end of June 2017, NZ$950 million was moved away from companies with high exposure to carbon emissions and reserves into companies with lower carbon risk
- Applies to passive equities portfolio only.
- Based on a bespoke carbon measure for listed equities developed in partnership with MSCI ESG
- We continue to hold some companies with carbon exposure where they are engaging and managing the risks
- We may continue active investments in companies with carbon exposure
- Not an exclusions strategy
- Carbon exposure was highly concentrated in a relatively small group of companies.

Reduce Equities: Results

Fund carbon footprint as a 1 July 2017

Outlook

- Over the long term we expect average returns of approximately 8% a year, based on current portfolio settings
- The global economic outlook is better than it has been for several years. However, with many asset classes globally at or above full value, returns are likely to normalize
- Fund continues to be strongly weighted to growth assets – we are prepared to weather short-term volatility for a better long-term return
- The Fund’s advantages (our endowments) – long-term horizon, known liquidity, operational independence and Crown ownership – give important advantages as an investor
- Operationally, we are focused on:
  - Fewer, deeper relationships with external investment managers
  - Increased direct investment in NZ and globally
  - Scalability and efficiency as the Fund continues to grow in size