NZSUPERFUND
Te Kaitiaki Tahua Penihana Kaumātua o Aotearoa

TITLE:

Guardians of New Zealand Superannuation

2019/20 Review

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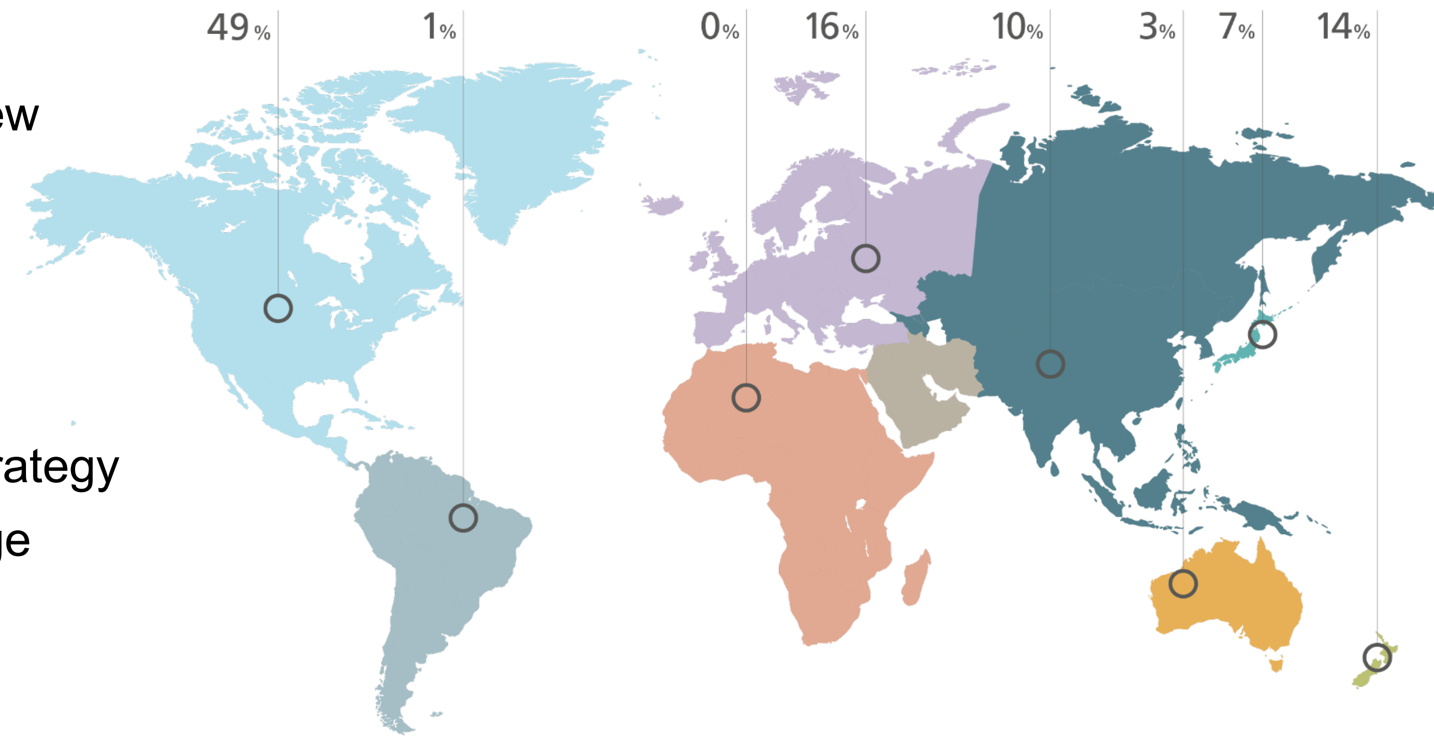
EVENT | PRESENTATION:

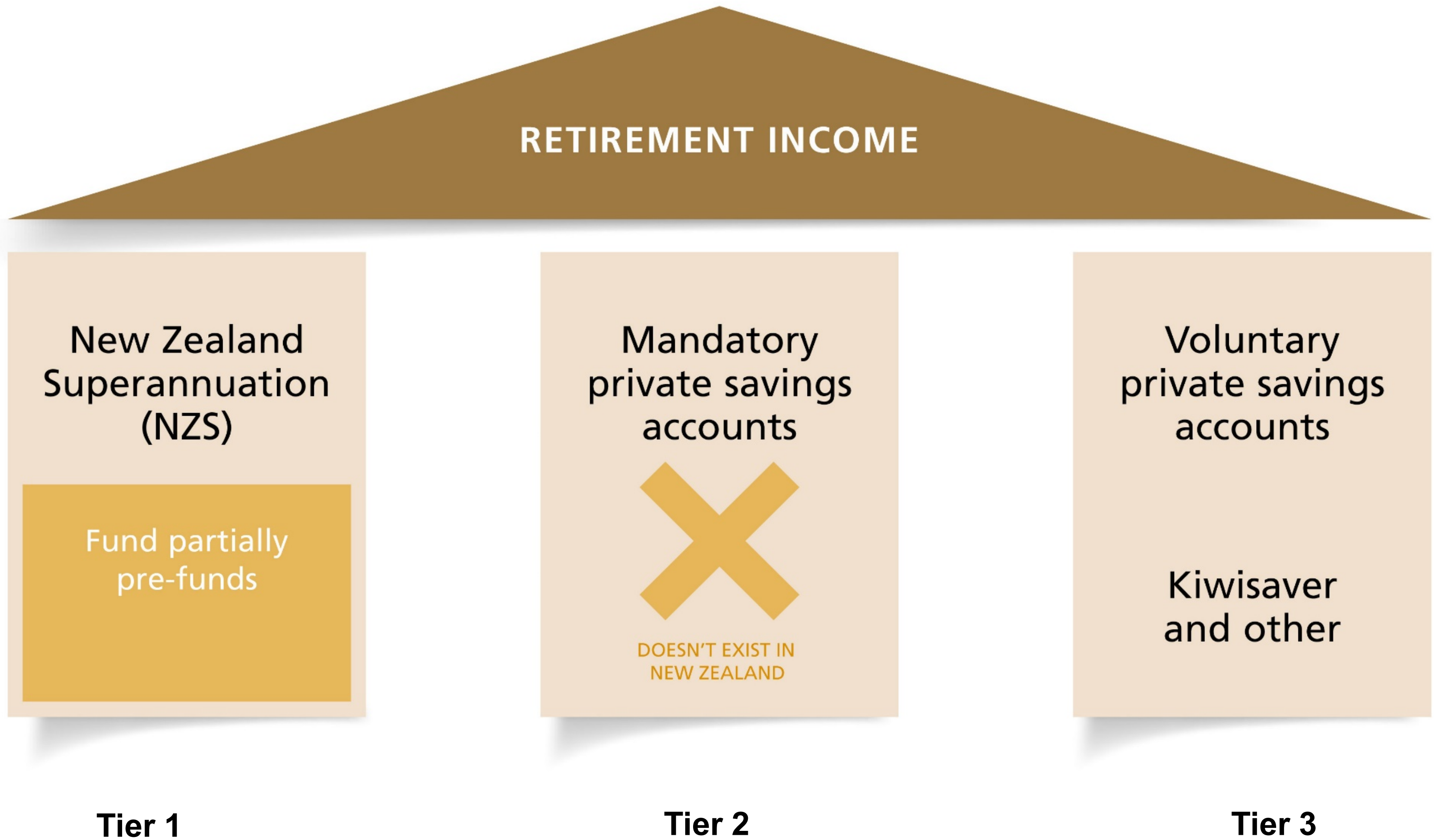
Finance & Expenditure Select Committee, 3 March 2021

Agenda

- Our role and mandate
- Investment approach
- COVID-19
- Investing in New Zealand
- Benchmarking
- Performance
- ESG
- Reset of RI Strategy
- Climate Change
- Outlook



Where we fit in – part prefunding Tier 1



- 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

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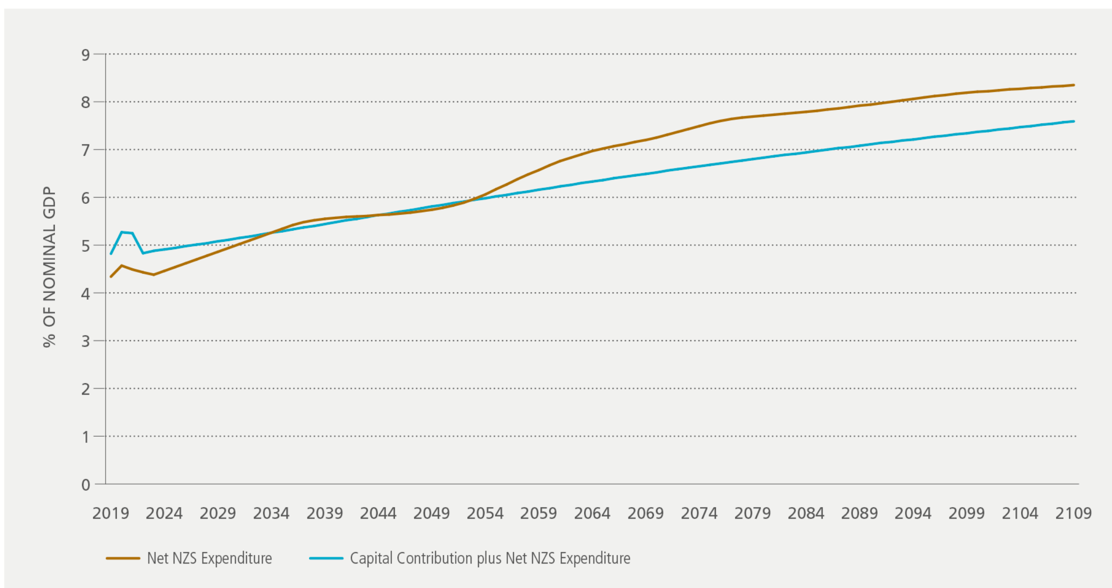
NZ Super Fund role and purpose

- The NZ Super Fund exists to ‘smooth out’ the increasing cost of government-provided superannuation. By contributing to the Fund out of current taxes, a pool of wealth (the Fund) is created that can be used to partially pay for superannuation, reducing the need for future generations of workers to see taxes rise or government spending cuts.
- At a future date, dependent on the growth of superannuation costs versus that of the economy and the Fund’s performance, the government of that time will be able to receive funds each year from the Fund, rather than provide it with funds (contributions). This will help future taxpayers partially cover the costs of superannuation, which will have risen not just in nominal terms, but more significantly, as a share of the economy.

Contribution rate graph



Governance framework

- The Guardians of New Zealand 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 NZ Super Fund. The Fund is a pool of Crown assets.

Mandates

- **NZ Super Fund Mandate** (Act of Parliament, 2001):
  - The Guardians must invest the NZ Super 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.
- **Venture Capital Fund Mandate** (Act of Parliament, 2019):
  - The Guardians must invest the venture capital fund in New Zealand's venture capital markets using best-practice investment management that is appropriate for institutional investment in those markets. It must manage and administer the fund in a manner consistent with:
    - The policy statement; and
    - Avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

Investment approach

We look to utilise the NZ Super 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.

COVID-19: Investing in a market downturn

Because of the high number of shares in our portfolio, the Fund is likely to suffer large financial losses in a market crisis. It is largely unavoidable that a growth-orientated portfolio such as the Fund will fall in these periods.

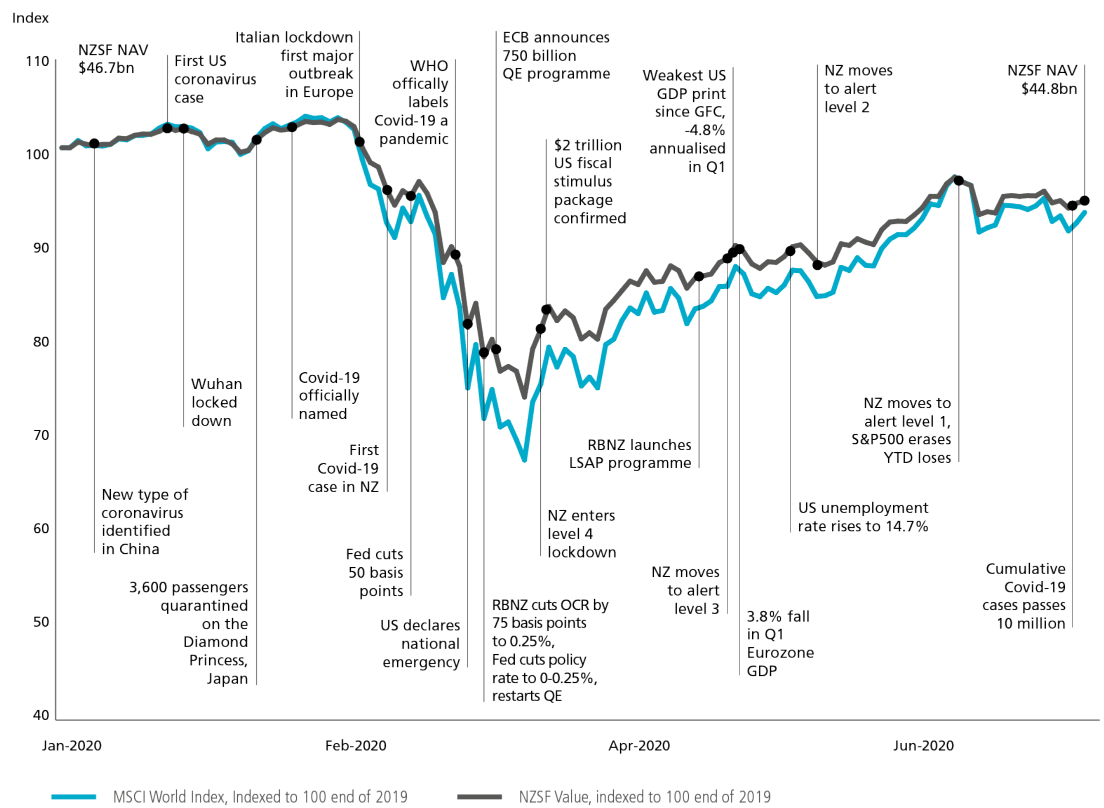
- At the height of the COVID uncertainty in February and March last year, the Fund was down 28%, losing around $13.4 billion in value.
- Following this, the Fund experienced the fastest period of growth since its inception, making a 53% return since March 2020 (as at February 2021).

In return for taking on market risk, we expect the Fund to earn higher returns in the long-run.

In addition, the Fund's endowments allow it to run contrarian investment strategies (we buy more assets as they fall in value). This exacerbates short-term losses, but as a long-term investor, market drops are an opportunity for us - we expect to be rewarded for this over the long-term.

The Fund is well-placed to wear such losses, as there is no immediate need to withdraw capital from it. Short-term losses can be treated as "paper losses" with little long-term ramifications for the Fund's ability to fulfil its purpose.

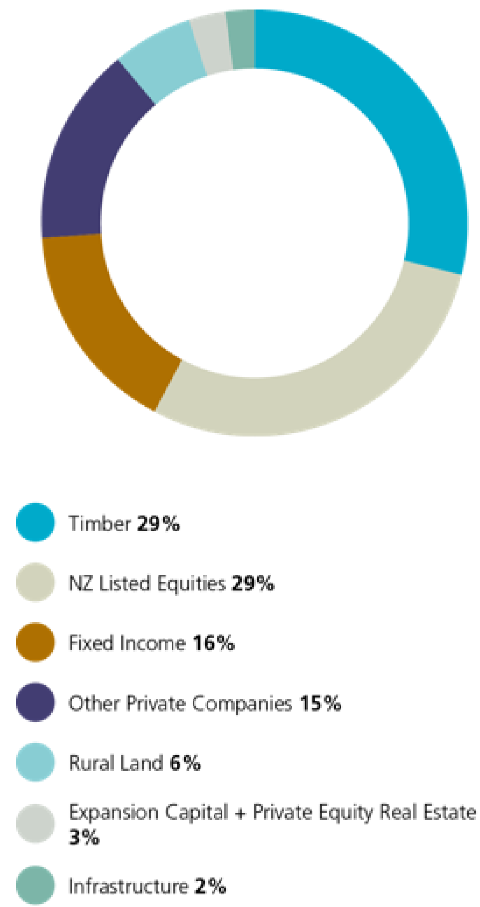
This belief relies, however, on stakeholder support for staying the course through periods of poor performance.



Investing in New Zealand

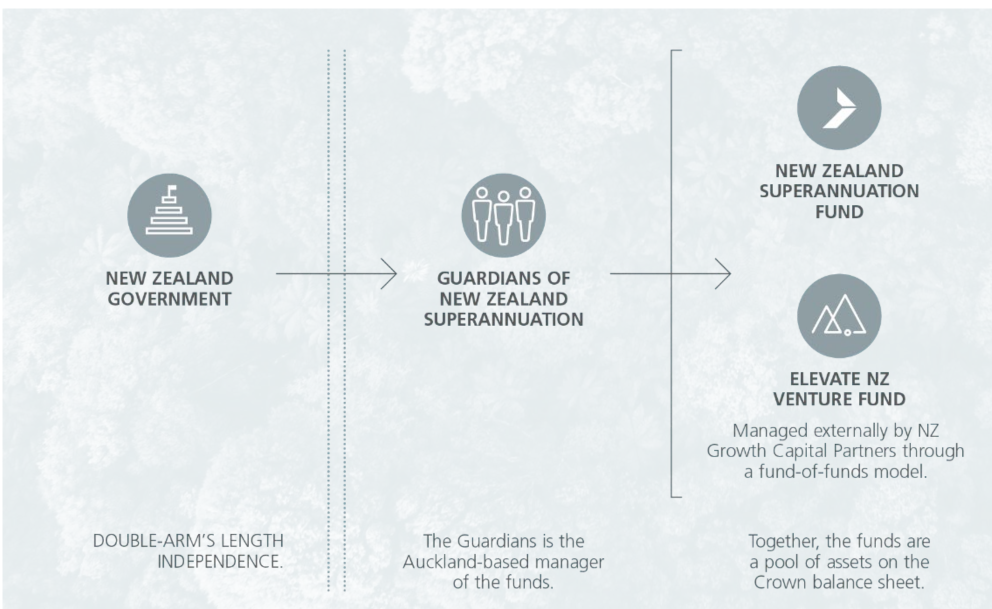
- Ministerial Directive (2009)
  - "…that opportunities that would enable the Guardians to increase the allocation of New Zealand assets in the Fund should be appropriately **identified** and **considered**…"
  - "This direction is not intended to be **inconsistent** with the Guardians' duty to invest 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 30 June 2020, the Fund had $7.2 billion invested in New Zealand.
- In the eleven years since we received the Directive, the proportion of the overall Fund that is invested in New Zealand (in value terms) has dropped from 21% to 18%. The proportional drop reflects the strong performance of global equities in recent years, even after significant new investments in New Zealand.
- The Fund is one of the largest institutional investors in New Zealand and plays a significant role in New Zealand's capital markets
- Investments include Kiwibank, Datacom, Fidelity Life, NZ Gourmet, Kaingaroa Timberlands, Asia Pacific Health Group (APHG), NZ dairy farms, housing, NZ equities and (via external managers) in growth capital and infrastructure.

NZ Investments



Investing in NZ: New mandate – developing NZ's venture capital market

- The Elevate NZ Venture Fund consists of $260 million of initial Crown commitments, expected to reach $300 million over time.
- Guardians oversees NZ Growth Capital Partners (NZGCP) management of Elevate Fund's investment into venture capital funds.



ELEVATE
NZ VENTURE FUND

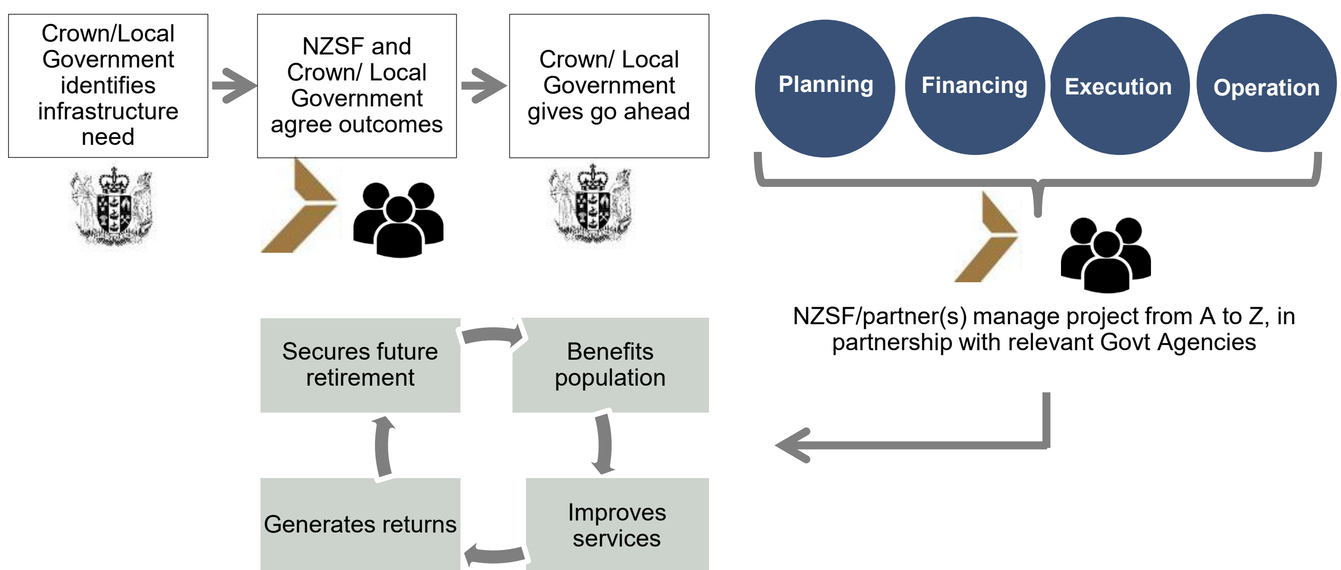
Elevate NZ Venture Fund - Framework

- Venture Capital Fund Act 2019
  - **Purpose**: of Elevate NZ Venture Fund a) capital to NZ companies; b) develop NZ venture capital markets
  - **Our mandate:** to apply best practice investment management appropriate for institutional investment in context of NZ venture capital markets
  - **Benchmark:** no financial return benchmark
  - **NZGCP:** appointed external manager
  - **Fund of funds model**: NZGCP allocates capital to fund managers who can attract matching private sector capital; fund managers deploy capital to investee companies

- Market Development: NZGCP tasked with wider market development
- Elevate NZ Venture Fund launched in March 2020
- Legislation supported by Policy Statement
  - Sets broad investment parameters to ensure capital deployment aligns with policy intention
  - Elevate NZ Venture Fund capital to be “wholly or substantially” invested in NZ entities and through NZ connected funds

Investing in NZ: Developing a model for transformational infrastructure and urban development projects

- New Zealand has an infrastructure and housing deficit and needs unprecedented levels of investment to ensure our transport, energy, water and housing are fit for success in the 21st century.
- We are working on refining an end-to-end investment and delivery model that builds on the Public-Public Investor ("PPI") Model that was used for our Auckland Light Rail proposal.
- This model will bring together our long-term equity capital and deep local knowledge, alongside local and central Government and a global network of specialists, to create transformational projects.
- Importantly, the returns on our investment will go back into the pockets of New Zealanders while allowing us to invest significantly in New Zealand's future growth now.



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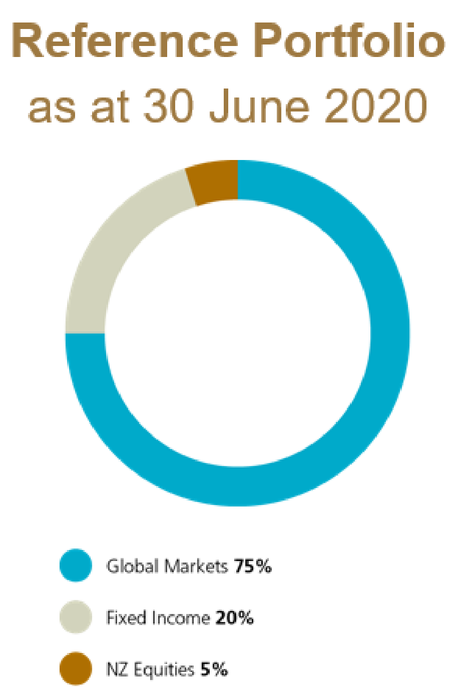
Benchmarks

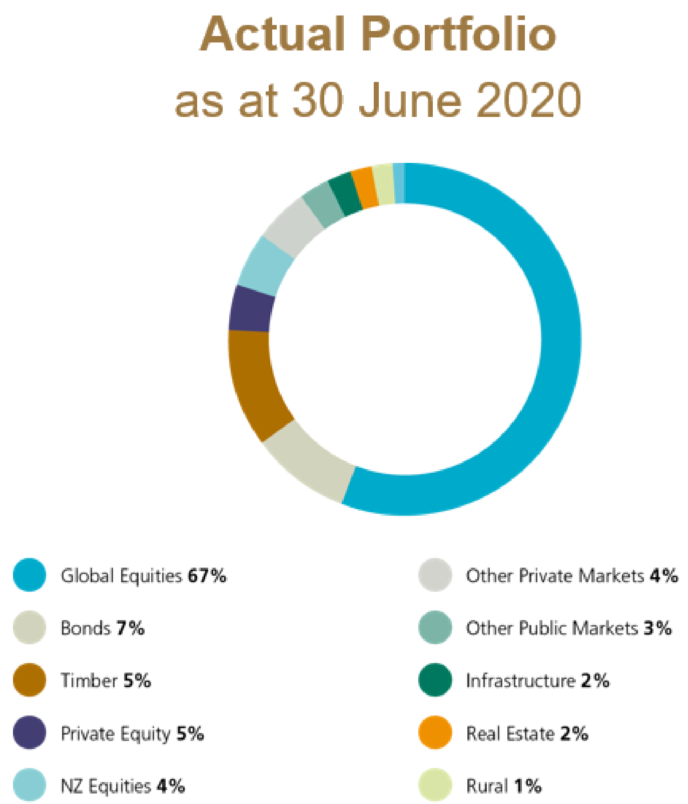
We benchmark against best practice industry principles, measures and relevant global peer funds

	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, ‘19 OAG special performance audit (‘08) SWF GAAP Select Committee Reviews	
Performance	NZ T Bill rate + 2.8% 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 portfolio + active investments = Actual Portfolio

Growth-oriented portfolio, majority passive, highly diversified



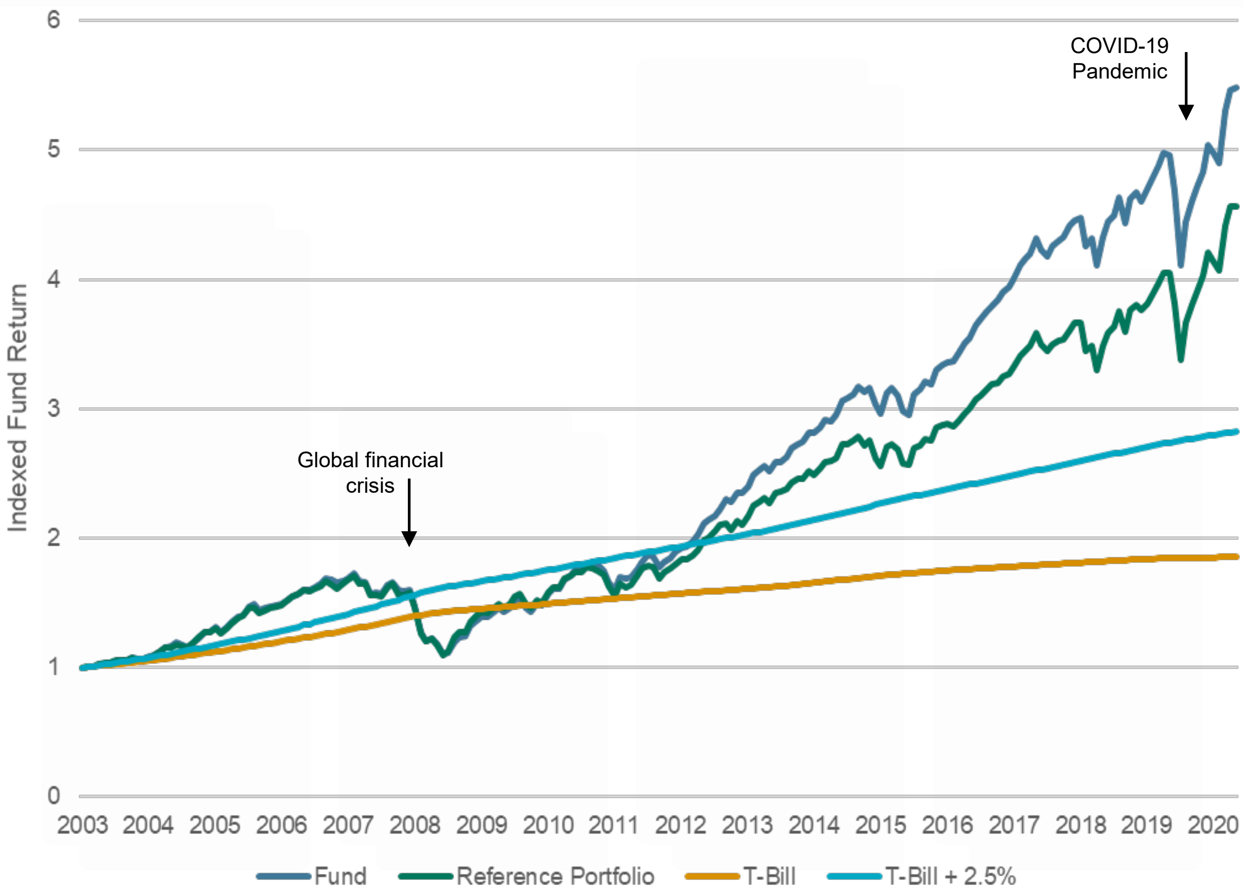


Performance (as at December 2020)

	Dec 2020	Last 12 months	Last 5 years	Last 10 years	Since inception
Contributions received	$0.18 billion	$1.79 billion	$4.02 billion	$4.02 billion	$18.9 billion
Actual Fund Return	2.96%	9.68%	11.99%	12.50%	10.28%
Reference Portfolio Return	3.27%	12.62%	11.13%	10.45%	9.14%
Value-Added (Actual return less Reference Portfolio return)	-0.32%	-2.94%	0.85%	2.05%	1.14%
NZ tax (paid) / received*	$0 billion	$(0.51) billion	$(2.93) billion	$(5.90) billion	$(7.42) billion
Closing Fund balance as at 31 December 2020	**$52.652 billion**				

Performance

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



Exceeded Reference Portfolio by $8.9 billion (1.16% pa)

Exceeded Treasury Bills by $33.2 billion 6.65% pa

Total Fund Returns 10.26% pa

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

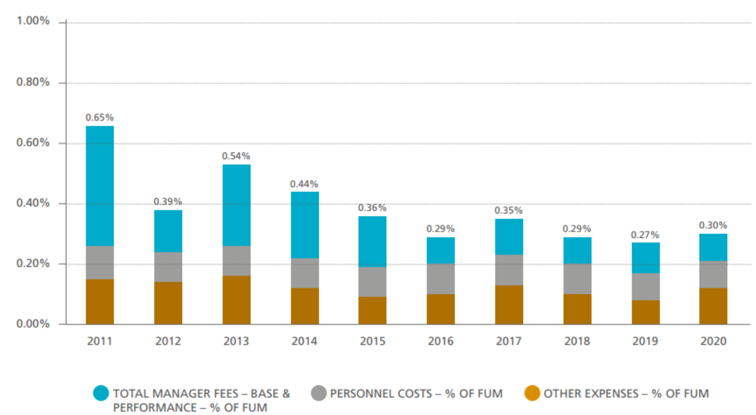
Treasury Bill return - a measure of the cost to the Government of contributing to the Fund instead of paying down debt

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 over the relevant five-year period
- The Fund's costs as a percentage of assets have reduced over time
- The Fund is described as "slightly low cost" because of its implementation style, which were mostly offset because of higher cost of services (compared to peers)

Fund Expenditure as a Percentage of Funds Under Management as at 30 June 2020



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

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Resetting the RI Compass

Responsible Investment practice is evolving rapidly, with the development of new tools, data and investment opportunities. Resetting the RI Compass is a project to refresh our RI strategy and develop an implementation road map, so continue to improve our performance and are ably positioned to respond to emerging trends. It is a strategic priority for 2021/22.

RI Compass project goal: To develop an RI strategy that is fit for the future, feasible to implement, and orientated to maintaining our social license to operate over the medium to long term.

RI Compass work steams

Emerging Trends & External Stakeholders

Understanding the context & expectations

Emerging trends relevant for the Guardians
What our peer funds are doing
Engagement with external experts
External stakeholder engagement
Internal engagement

ESG Performance

Achieving better ESG performance across the portfolio

Principles & definition
ESG performance in the context of the NZ Super Fund mandate
Tools and practice
Integration into the investment process
Options for an improved ESG performance framework
Options for implementation

Positive Investment

Developing a positive investment plan

Guardians' definition of Positive Investment
Positive Investment that supports and is consistent with the NZ Super Fund mandate
How to identify and measure social and environmental impact
Options for implementing the PI plan

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Climate change is an investment risk

As a Fund with a very long horizon, we believe climate change is one of the Fund's most critical investment risks and opportunities.

CLIMATE CHANGE INVESTMENT RISK STRATEGY

GOAL
A portfolio more resilient to climate-related risks.

TARGETS
By 2025: to reduce the carbon emission intensity of the Fund by at least 40%; and reduce the carbon reserves of the Fund by at least 80%.

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.

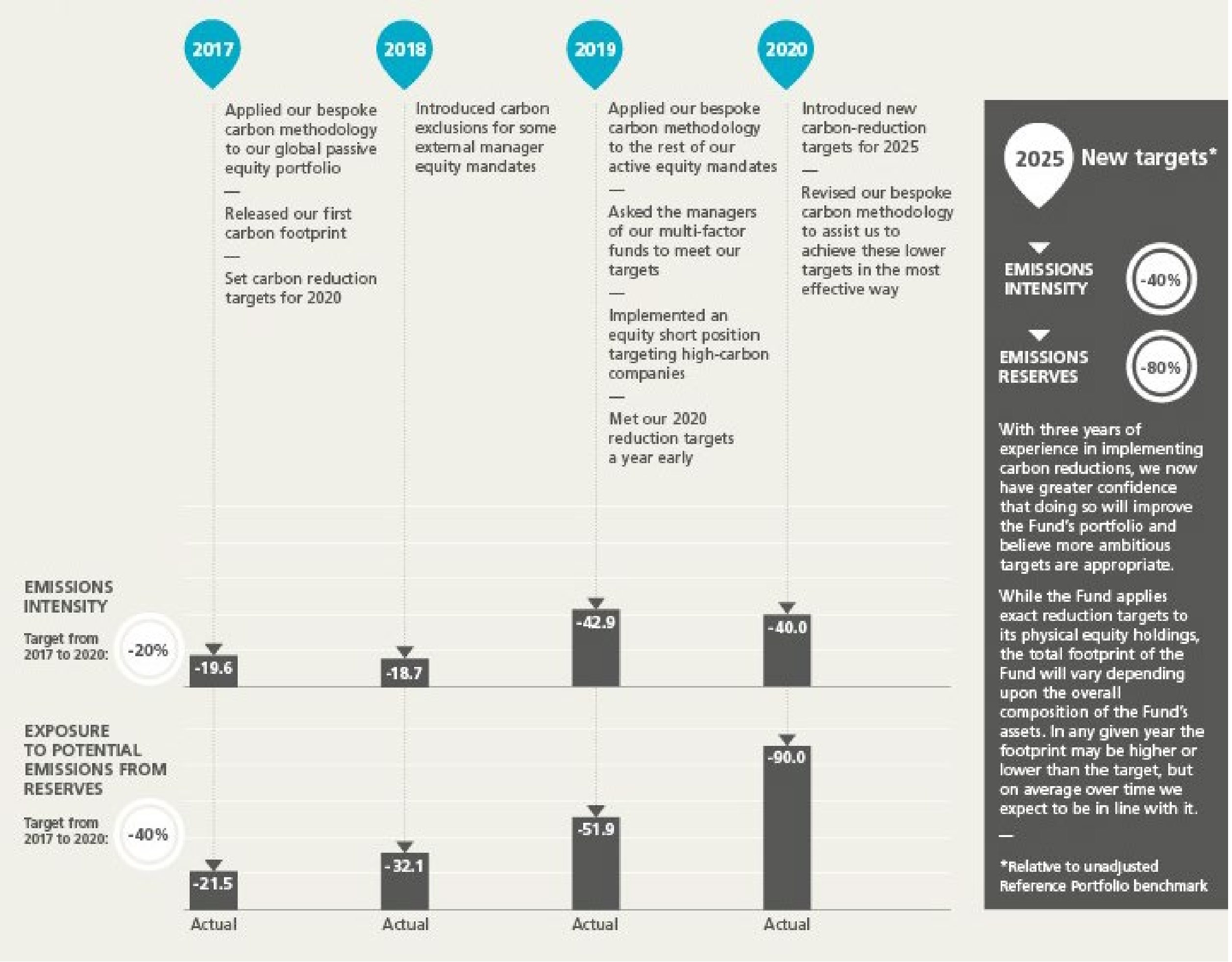
ENGAGE
Manage climate risks by being an active owner through voting and engagement.

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

Climate strategy implementation

Reduce, Analyse, Engage, Search

- The aim of the NZ Super Fund Climate Change Investment Strategy is to improve investment resilience to climate change risk over the long-term horizon of the Fund.
- Our strategy also guides us in capturing opportunities from the transition to a low-carbon global economy.
- We believe our strategy is good for the portfolio and consistent with our mandate to maximise returns without undue risk.
- The strategy covers the whole Fund and implementation is ongoing. We have focused on the areas where we have the most control and where risk (transitional and physical) or opportunity is greatest.
- One of the core elements of our strategy is to reduce the carbon intensity of the Fund's investments and its exposure to fossil fuel reserves.
- We met our 2020 carbon reduction targets in the 2018/19 financial year. During 2019/20, we set new targets to reduce our portfolio's carbon emissions intensity by -40% and -80% by 2025.
- In 2020, we published our first report against the reporting recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). Report a copy here.



Climate Change - Next steps

- We reapply the carbon reduction methodology to the passive (developed and emerging) equities portfolio each year.
- We expect to adjust and refine the carbon methodology over time as carbon measurement tools and data improve.
- Current priorities are:
  - Reduce carbon exposure in our active investment portfolio. We have applied the carbon methodology to the Fund’s New Zealand active equity mandates and global equity factor mandates;
  - Understand valuation risks in direct investments and work through scenario analysis;
  - Engage with external investment managers and with investee companies.
- We continue to search for attractive investment opportunities in alternative energy and transformational infrastructure.
- We report in our Annual Report on progress towards meeting our 2025 targets.

Outlook

- The Fund's advantages (our endowments) – long-term horizon, known liquidity, operational independence and Crown ownership – give it important advantages as an investor.
- The Fund continues to be strongly weighted to growth assets – we are prepared to weather short-term volatility for a better long-term return.
- Over the very long-term we expect average returns of approximately 7.8% a year, as a result of that weighting towards growth assets.
- We remain interested in investing in large-scale infrastructure and real estate projects (both in New Zealand and internationally), which we see as attractive investment opportunities because of their consistent, competitive returns and yields, and diversification benefits.
- In recent years, we have enjoyed strong returns from equities. Part of the reason for this is low interest rates. However, low interest rates now means we are seeing fewer attractive investment opportunities going forward. We are taking less active risk in the short-term, which means we expect less value-add, all other things being equal. This means the returns we expect from the Fund's portfolio over the next few years are lower than what they normally would be.
- Operationally, we are focused on:
  - Fewer, deeper relationships with external investment managers
  - Increased direct investment where we have an advantage, including in NZ
  - Scalability and efficiency as the Fund continues to grow