2019/20 Post-hearing questions for Guardians of New Zealand Superannuation

GENDER PAY GAP

The Committee notes the Guardians' disappointment with its gender pay gap result for 2020.

137. What steps are the Guardians taking to close the gender pay gap, and increase the percentage of females on the Board, Leadership team and in the workforce as a whole?

Reducing our gender pay gap is an ongoing focus. We are addressing this through a diversity and inclusiveness policy; a flexible work policy; and a revised leave and benefits policy.

The diversity and inclusiveness policy is available on our website here. We strive to create an environment where all of our team members, no matter who they are, are encouraged and empowered to be themselves.

The flexible work policy is designed to support the adoption of working from-home, part-time work, flexi-time work, condensed hours work patterns and job share arrangements.

The comprehensive review of staff leave and benefits has resulted in a number of changes to employment conditions at the Guardians, including:

- a top-up to the Government's paid parental leave allowance to full pay for a period of up to 26 weeks;
- up to 64 paid 'Keep in Touch' hours for people on parental leave;
- ensuring Kiwisaver payments continue during the first 26 weeks of parental leave, calculated based on full pay; and
- a 'make good' KiwiSaver lump payment for staff who choose to take extended parental leave of up to 52 weeks, six months after they return from parental leave. This ensures staff do not miss out on employer KiwiSaver contributions during unpaid extended leave.

To mitigate for conscious or unconscious bias within recruitment agencies, we also routinely brief such agencies to ensure each short list they present includes at least one third women.

Performance is reviewed annually through a formal process that includes a calibration exercise by the Leadership Team that is designed to mitigate against conscious or unconscious bias. Pay is reviewed annually including through an equity lens.

Note: The Guardians has no influence over female representation on the Guardians' Board. The Board is appointed by the Minister of Finance from a pool of candidates selected by an Independent Nominating Committee.

138. What actions are the Guardians taking to encourage female talent to remain in the industry?

In addition to the changes noted above, our CEO Matt Whineray has joined the recently launched Executive Committee for the Australia & New Zealand chapter of the Bloomberg Women's Buy-side Network. Comprising some of the region's most influential asset owners and asset managers, the chapter aims to inspire next generation investors, elevate female role-models, and grow the pipeline of female leaders in asset management.

The Guardians is also a supporter of the INFINZ Young Women in Finance network, which was founded by one of our staff members during her period of employment with us and is Chaired by a current staff member.

In 2018 we introduced a Domestic Violence Policy and family violence support procedures. We have partnered with SHINE to educate and formally train our employees about domestic violence, and have appointed and supported a group of staff members as Family Violence first responders to provide effective support to victims. Ten days of paid leave is available annually to an employee who is affected by family violence.

Our response to the Covid pandemic also included a suite of employee support measures such as access to special leave for staff who needed it, in recognition of the load being carried by caregivers.

MAORI

The Committee notes that as at 30 June 2020 1% of the Guardians' workforce identified as Māori:

139. Please outline the Guardians' Māori engagement strategy.

We continue to invest significantly in our engagements with Māori groups. This work has included sponsoring the establishment of the $115.5 million Te Pūia Tāpapa Fund and developing a preferred partnership agreement with it. The Te Pūia Tāpapa Fund is a way for Iwi and Māori organisations to pool resources and access larger scale direct investment opportunities. Its investors represent diversity of scale and geography comprising Iwi and Māori entities located in Te Tau Ihu (Nelson-Marlborough), lower and central North Island, Taranaki, Waikato, Bay of Plenty, Hauraki, Northland, Auckland and Wharekauri (Chatham Islands). Under the preferred partnership arrangement the Te Pūia Tāpapa Fund is a co-investor alongside the NZ Super Fund in New Zealand companies TR Group and APHG (Labtests).

We are also partnered with iwi/Māori investors in the NZ Super Fund's investment in Kaingaroa Timberlands (we brought Kakano Investments into the investment) and the Fund's investment in residential property in Hobsonville, Auckland, alongside Ngai Tāhu. We value these relationships and work closely with our fellow investors.

Other Māori engagement initiatives include:

- a short term placement of a Guardians staff member with Ngai Tāhu in 2021, an initiative which will facilitate capability building and knowledge exchange for both parties; and
- outreach to key Māori/iwi groups to understand their expectations of what the Guardians' social licence to operate looks like, as part of the work we are doing on the refresh of our responsible investment strategy.

140. What steps are the Guardians' taking to encourage Māori talent into the industry?

The Guardians is a long-time supporter of the TupuToa internship programme – a pathway that provides professional opportunities for Māori and Pacific tertiary students into corporate, government and community organisations.

Following a recommendation in 2019 in the Willis Towers Watson independent review of the Guardians and Fund, we developed an employment value proposition and brand for internal and external use, including on a new careers website. Supporting our commitment to diversity and inclusion was fundamental to our creative approach to the employment brand, which includes images of a diverse group of staff members and use of Māori language.

RECRUITMENT

The Committee notes that in 2019/20, the Guardians FTE number increased by 15.7:

141. How is Covid-19 currently affecting recruitment?

Aligned with our long term horizon, we have looked through the short term impact of Covid-19 and continued to build the required people capability to execute on our mandates. Hence, recruitment activity has continued as planned.

142. Have the ongoing border closures affected the Guardians' ability to recruit the talent it needs; if so, how are the resulting risks being managed?

No. We have been able to source talent locally, and have been lucky to tap into a number of highly skilled New Zealanders who have chosen to return to New Zealand post the Covid-19 outbreak. However, we recognise that the labour market is tightening up. Anecdotally, we have observed increased competition in some talent markets such as risk. This has resulted in a slightly longer time to hire for a couple of our risk vacancies.

Like many others within the investment sector, we are well versed at operating in a tight labour market given the specialist skills we employ at the Guardians. We are investing in our HR Technology (including out talent pooling capability) to maximise our ability to tap into talent within the New Zealand market and Kiwi's abroad. To attract top talent, the Guardians aims to offer an attractive mix of benefits, learning and development, culture and engagement, parental leave, flexible work arrangements, amongst other things, to build an attractive workplace. As noted above, at our answer to Q140, we have also defined our employee value proposition, and developed a careers website to ensure this is clearly communicated externally.

VALUATION

Valuation represents a significant process for the Guardians and the Fund.

143. Please comment on the process undertaken to value investments for 2019/20 along with key challenges and judgements faced.
144. How did Covid-19 affect the valuation process? What were the specific risks and challenges and how did the Guardians and the Fund respond to these?

While financial markets had largely recovered to pre-Covid-19 levels by 30 June 2020, there had been significant volatility during the year. While the pandemic persists, significant uncertainty remains about:

- certain judgements and estimates used in 30 June 2020 valuations; and
- the extent of financial impact that the volatility in financial markets will have on the determination of fair value in future periods.

In particular, certain unobservable valuation inputs used may be less reliable e.g. where fair value is determined using valuation models based on the price of recent and comparable transactions.

The Guardians has established an internal Valuation Working Group that is responsible for reviewing the valuations of certain investments at balance date. The Valuation Working Group reviews the valuation methodologies, practices and policies used in determining fair value and/or reviews the valuations themselves with a view to ensuring that the fair values of these investments at balance date are as accurate as possible.

The independent valuations of certain investments within the private equity and unconsolidated subsidiaries categories received particular attention and scrutiny from the Valuation Working Group for the year ended 30 June 2020 as a result of the Covid-19 pandemic. For these investments, the valuations were reviewed in-depth and compared with internally-developed valuation models. As part of this process, management:

- verified key valuation inputs;
- reviewed valuation methodologies;
- assessed valuation movements since the prior year; and
- held extensive discussions with the valuers to assess the reasonableness of the valuations.

In certain cases, where appropriate, management have adopted a lower valuation than recommended by the independent valuers.

Reporting from investment managers regarding externally-managed vehicles has also been scrutinised to ensure the impact of Covid-19 has been adequately considered and reflected in the valuation of the investments under their stewardship.

Please refer to pages 162, 172, 178, 180-181 of our 2019/20 Annual Report for information about the valuation process. Note 2(a), 2(b), 2(e) and Note 8(b) contain further disclosures on the impact of the Covid-19 pandemic.

145. In light of the ongoing pandemic, how are the Guardians and the Fund preparing for the 2020/21 valuation process?

Our approach remains consistent with that applied for the 2019/20 financial year.

EMPLOYEE INCENTIVE SCHEME

146. Please update the Committee on the operation of the employee incentive scheme.

At the request of the Guardians' Board, a review of our remuneration and bonus structure design was commenced in 2018/19, and completed in 2019/20. Our purpose was to ensure that the way the Guardians remunerates and incentivises our staff is:

- fit for purpose;
- consistent with our desired culture;
- appropriate for the type of mandates we have; and
- ensures that the Guardians can attract and retain skilled and diverse talent in a competitive market.

The Board engaged independent experts McLagan for advice and analysis of the Guardians' incentive rates against industry benchmarks in New Zealand and globally, to inform how competitive and appropriate our offering is. McLagan indicated the Guardians' remuneration strategy was broadly fit for purpose and market competitive, and met the objectives of a strong remuneration strategy.

Having satisfied itself that the foundational principles of its remuneration strategy and design remained fit for purpose, the Board made no fundamental changes to the strategy. Minor changes were made to allow new employees who qualify for the Fund performance bonus to be eligible for all four active bonus vintages from the commencement of their employment. Changes were also made to the calculation methodologies for rewarding merit increases and netting interim at risk payments, to align the outcomes more closely with the programme's intent.

A comprehensive outline of the Guardians' incentive programme is contained at pages 101-105 of the Guardians' 2019/20 Annual Report. In summary, the scheme is designed to incentivise employees and create a culture of good performance. All bonuses are at the discretion of the Board. There are two components to the scheme:

1. An individual performance component for which all permanent employees are eligible; and
2. A two-part NZ Super Fund performance component, which applies to permanent members of the Leadership, Investments and Portfolio Completion teams. These measures are based on whole-of-Fund performance and payments are made over four years on a rolling average basis. Payments made in any one year therefore reflect a four-year moving history. This is intended to incentivise appropriate risk-taking and reflect the Fund's focus on long-term performance.

Noting the impact of the Covid-19 pandemic on financial markets, our view is that the employee incentive scheme is working in the way it has been designed to do – payments were considerably lower for the 2019/20 financial year, reflecting lower Fund performance for that year.

The total at risk payment was $6.5m (down from $8.8m in 2019), representing a decline of 27%. The Fund performance component was reduced by 60% from the previous year. Because of the four-year rolling average structure explained above, this financial year's lower performance will also impact negatively on payments for the next three years.

The Guardians elected not to give senior staff a salary increase for 2020/21 and the CEO and Board members voluntarily took a 20 percent cut to base remuneration for 6 months from April 2020. No members of the broader senior management group received a salary increase. A small number of roles outside the senior management group did receive increases for individual-specific reasons including equity.

PEOPLE CAPABILITY AND CAPACITY

147. What are the main people capability and capacity challenges faced by the Guardians and the Fund.

Attracting and retaining a diverse mix of talent remains a challenge for the Guardians, with specific reference to attracting and retaining Māori and Pasifika candidates and attracting women to front office positions. Secondly, we have noticed increasing difficulty in attracting and retaining talent due to competitive remuneration practices in the market. Across the board, the skills we require are in high demand, putting our remuneration frameworks under pressure.

148. Has Covid-19 created any new challenges in this space? How are these challenges being addressed?

Maintenance of our positive culture in a more remote environment has been a new challenge through 2021. Increased levels of communication, leadership focus and action planning and remote social events have all helped. The health and wellbeing of our people has also been a topic where increased focus has been necessary. We have expanded our Employee Assistance Programme offering, we survey staff regularly on their perceptions of mental and physical health and we have provided support to enable appropriate home-office set up. Finally, we are also mindful of the reduced talent flow into New Zealand due to travel restrictions. We are focussing on marketing our employee value proposition domestically to ensure we are able to fill roles with the necessary skills and experience.

FUND PERFORMANCE – COVID-19

The Committee notes that the disruption the Covid-19 pandemic had on financial markets in 2019/20 affected the Fund's performance.

149. *Please outline how the Covid-19 pandemic affected the performance of the Fund in 2019/20?*

150. *How is the pandemic affecting the performance of the Fund in 2020/21?*

At its pre-Covid peak the Fund was $48 billion and at its lowest point in March 2020, when Covid shocked the market, it was $35 billion. By June 2020 it had recovered to $44 billion and as at 28 February 2021 the Fund sat at $54 billion. (Government contributions to the Fund since 1 March 2020 have totalled $1.9 billion.) Therefore, since the low point in March 2020, the Fund has rebounded very strongly, returning a cumulative 53 percent. This represents the fastest period of growth since its inception.

151. *How has the pandemic affected the way that the Fund is managed?*

We note that the pandemic currently prevents us travelling overseas for business, and has also curtailed domestic travel over the last year. Notwithstanding the capabilities of digital video technology, we are looking forward to being able to resume international travel (though likely at a lower level than before) and being able to receive international visitors in Auckland. With approximately 85% of the Fund invested offshore our ability to meet in person with overseas investee companies, fund managers, suppliers, educational providers and peer networks remains important from both a risk and an opportunity point of view.

152. *What risks does the pandemic present in terms of the Fund achieving its longer term objectives?*

As a long-term investor the Fund was well-positioned to take advantage of the market volatility presented by the Covid crisis through use of the counter-cyclical investment strategy outlined in our response to Q153 and our operational preparedness as outlined at Q154.

For further information on how we are thinking about the medium- and long-term economic and investment implications of the pandemic please refer to the feature on Covid by our Chief Investment Officer at pages 32 and 33 of our 2019/20 Annual Report.

STRATEGIC TILTING

The Committee notes that in its Annual Report, the Guardians and Fund state that the Fund is well positioned to take advantage of market opportunities via a counter-cyclical strategy:

153. *Please outline this strategy and how it has been implemented to date.*

The counter-cyclical strategy that we employ is called Strategic tilting. Strategic tilting is a value-adding strategy which alters the Fund's exposures to certain asset classes, including equities, bonds, credit and currencies. This strategy is designed to capitalise on certain investment advantages that the Fund has. These advantages are two of the Fund's endowments, specifically the Fund's long-term investment horizon and certain liquidity profile, and our belief in mean reversion of asset prices and risk premiums. Essentially, strategic tilting increases exposure to cheap assets and decreases exposure to expensive assets based on price and long-term valuation signals. This type of strategy is sometimes called dynamic or tactical asset allocation.

In summary, we invest in a contrarian style: buying when others want to sell and selling when others want to buy. Extreme market events like the Covid-19 crisis present and opportunity to take advantage of temporary price dislocations.

Contrarian strategies can be behaviourally difficult to run, in part because there will be significant periods where the strategy loses money. For this reason, good governance and the ability to hold positions through time is critically important.

Strategic tilting is implemented by our in-house investment professionals.

Further information on the strategic tilting strategy is available at pages 42-44 of our 2019/20 Annual Report and via a white paper available on our website here.

COVID-19 OPERATIONAL IMPACT

154. Please outline the effect of Covid-19 on the Guardians operations, including how the Guardians managed the effects of the national lockdown in March through June 2020.

We were organisationally equipped and ready to respond to the Covid-19 crisis. We moved quickly to cease business travel and took the precautionary step of moving to a remote working environment early, before the national lockdown was announced. Guardians staff worked remotely from their homes for approximately 12 weeks, from late-March until mid-June.

While the lockdown experience was challenging for staff, many of whom had family responsibilities to fulfil, from a technological and operational perspective, the Guardians managed well. Because of robust crisis management planning and, crucially, practice, we were well placed to execute a relatively smooth and early transition to remote working. Our technology and internal systems were fully operational throughout, and investment and organisational activity continued as normal. Our focus during the lockdown period was on making sure that the team felt connected and supported, with a number of employee wellness initiatives mobilised across April to June. These measures included proactively manging workload and bringing on additional resource where needed; allowances for home office set up; wellness packages; psychological support and special leave for staff who needed it. Staff feedback indicated people felt well supported.

A combination of earlier projects and initiatives helped ease the transition from working in the office to working at home:

- We had moved our IT infrastructure to the cloud in 2018 and have undergone regular technology upgrades since then.
- We run regular and rigorous business continuity planning and testing.
- Each year we model our liquidity by subjecting the Fund to various simulated shocks (or 'stress tests').

- From the beginning of the pandemic we significantly increased our focus on internal communications.
- We introduced a short, weekly, pulse-style survey using an online platform from Peakon. Initially, the focus of the survey was to help the management team and Board to understand the effectiveness of our Covid-19 response while staff were navigating the first few weeks back to office-based working. Beyond this, we expect the survey to provide useful feedback on staff engagement.

155. *What lessons did the Guardians learn from the national lockdown which it will be applying to its response to future lockdown events?*

We have undertaken a detailed lessons-learned exercise. Some of the key lessons have been:

- The technology that is now available to us means that we are able to work remotely more successfully than we had previously envisaged (for example, Guardians' Board meetings have been held very successfully using Zoom). As a result, as noted above, it is unlikely that international travel will resume at pre-pandemic levels.
- Many staff members have valued the flexibility offered by work-from-home arrangements, in particular the time saved commuting. Staff are now working from home more frequently than before. We expect this trend will continue and are aiming to embed and maximise the benefits of greater flexibility and remote working for individuals, teams and the organisation as a whole.

CUSTOMER RELATIONSHIP MANAGEMENT SYSTEM

156. *The Committee notes that the Guardians launched a new Customer Relationship Management system during the lockdown. How did this system contribute to the Guardians remaining operational during the lockdown? What other benefits is it providing?*

The Guardians launched a new Customer Relationship Management (CRM) system to track interactions with our external relationships in April 2020, replacing IRM, a system previously used by Guardians. CRM is used to track meetings, emails, phone calls and record information relevant to external relationships staff at the Guardians have interactions with. Our CRM system is intended to develop into a centralised hub that holds data relating to our business contacts including investment managers, subsidiaries, peer funds, vendors, government and community stakeholders.

In general, our CRM system was deployed to provide every staff member clear visibility and an organisation-wide view of our external stakeholders and to create structure and organisation to foster increased efficiency and productivity, whether working from the office or working from home. Deploying the CRM system during lockdown enabled a number of benefits to be realised, both expected and unforeseen, including:

- Giving everyone the opportunity to see what virtual meetings and interactions people across the Guardians were having when we couldn't easily catch up with people as we would in an office environment. It reduced potential additional catch-up calls or email updates.
- Providing a global contact list for investment managers, vendors and peers.
- Breaking down silos of information and sharing of knowledge across teams and functional areas enabling everyone to choose what information to follow and when to follow it.

Information and insights are important to make good investment decisions and CRM helps get that information and insights to the right teams and people, efficiently. During the lockdown, there was a flood of information on the impact of Covid-19 on markets and investments, overlaid by the challenges of sharing that material in a work-from-home world. CRM enabled us to efficiently organise and make that information accessible.

Deploying the CRM system during the lockdown demonstrated that the Guardians could successfully introduce new enterprise systems, provide relevant training and support and ongoing project governance with a dispersed work-from-home team. It was a Guardians-wide example of how we can be nimble and adapt, providing ongoing inspiration for other project roll-outs in an uncertain operating environment.

We continue to find new ways to use the tools that CRM offers and have recently completed a "benefits realisation review" of the system which highlighted the following other benefits:

- Providing access to information on investment managers, vendors and peers whenever and wherever it is needed, including on mobile devices
- Providing an intuitive interface for entering information, at the time of the interaction
- Reducing the number of systems used for recording stakeholder management information
- Automation of previously manual summaries of meetings (e.g. the Weekly Digest)
- Increasing use cases across the Guardians, originally intended to be used by teams that deal with external managers, it is also used by IT to manage vendors, Tax to manage advisers etc
- More efficient contact ownership so that contacts can be easily re-assigned as people change roles within the Guardians
- Live and interactive data makes it more useful for the end user. Staff can access CRM to see recent and upcoming meetings and recent activities including phone conversations and emails
- Prior to meetings with external parties, users can quickly scroll CRM to see what other discussions have been held with that partner historically. This ensures we are we're more informed when dealing with partners and seen as 'one team' or a joined up entity
- Twice a year a list of excluded securities is sent to our External Managers. Previously this has been a manual exercise using an excel spreadsheet and outlook emails. A small piece of work was undertaken to enable this to be automated through CRM. This work is complete and the first lists were mailed to Managers in November 2020.

Our CRM system is expected to become increasingly useful over time as we build up a history of our interactions with each contact and deliver additional benefits as we realise new use cases and ways to use this tool to increase knowledge sharing and connectivity.

DATA STRATEGY

157. The Committee notes that a key strategic focus for the Guardians in 2020/21 is the development of a data strategy. Please outline the Guardians' progress in developing this strategy to date.

The Guardians Data Strategy has been split into three key component parts:

1. **Data Services**, which is focused on the activities required to provide confidence that our data assets are fit for their intended purpose, and to enable proactive and effective business ownership of our investment data.
2. **Data Technology**, a programme of work that will provide data and related technical services, including systems and tooling required to gather data, manage data quality and provide the appropriate data access channels.
3. **Data Analytics**, which will be the bridge between data provision and data consumption. The focus of this component is to enable the fast and efficient creation of high quality reports and

models. Educate and promote best practices, usage of appropriate tools, and assisting users to navigate the available technical data capabilities.

Both the Data Services and the Data Analytics streams have required designing and recruiting new functions and roles as the capacity and/or the capabilities required to deliver the activities required were not previously available within the Guardians.

Outcomes

The desired outcomes of the data strategy work include:

- Find data management solutions that are tailored to our data users'/consumers' specific needs.
- Embed robust data quality reporting and monitoring at the beginning of the data production process.
- Enable the move towards real-time data.
- Improving organisational efficiency and productivity by removing manual reconciliations and manual data adjustments.
- Improved engagement and data stewardship by business users. Make it easier for business users to build trust and confidence in the data, but also make clear to them that they need to contribute to receive.
- Dynamic documentation of system and data architecture, that is accessible, relevant and transparent.
- Develop real-time, crowd-sourced "wiki" type documentation that encourages all subject matter experts to contribute, in preference to static artefacts that quickly become stale (e.g. Word or Excel documents).
- Implement an integrated data dictionary, data catalogue and business glossary solution, that is easy to use and keep up-to-date.
- Upgrade ad-hoc analysis capabilities, by implementing data analysis and business intelligence tools.
- Provide enough flexibility in core systems to limit off-system workarounds.
- Increased data accessibility in a controlled and regulated framework.

Progress to date:

- A specialist Data Services team has created and a Head of Data Services was appointed and started in February 2021.
- Recruitment is underway for a Manager of Data Analytics.
- Conducted a thorough assessment of; potential technology solution providers, data as a service (DaaS) partners, as well the approaches adopted by a number of our peer organisations. This was under the guidance of an independent, specialist asset & investment management consulting organisation.
- A preferred technology solution has been identified, and is currently being developed into a business case for Executive approval.

Next Steps

Foundational Tasks

- Remove dependency on components in our user-interface layer which will be out of support late 2021. This reduces risk and ensures medium-term viability of our current platform.

- Choose core business tools for data quality and application management, gain IT approval ready for implementation.
- Choose instrument static data ("security master") source(s), gain IT approval ready for use.
- Develop our new Data Backbone
- Implement core data quality and monitoring technologies.
- Install and set up core data backbone components, begin migration into the new platform.
- Complete work to provide mid-term alternatives to certain Excel based reports and analysis.
- Removal of Legacy Technology
- Progressively update all data sources and migrate to new data backbone.
- Complete migration of analytical models to new data sources.

REFERENCE PORTFOLIO REVIEW

The Committee notes that the Guardians have completed its latest five yearly review of the Reference Portfolio in 2020.

158. Please outline the results of the review and how the Reference Portfolio has been altered in light of this review?

The review reaffirmed the Reference Portfolio's strong weighting towards growth assets, retaining an 80% allocation to growth assets (equities) and 20% to fixed income assets (bonds). An existing 5% allocation to listed New Zealand equities also remains unchanged. There has been a minor change to the structuring of the global equities exposure within the Reference Portfolio. Further details are contained in the case study on the Reference Portfolio Review at pages 40-41 of our 2019/20 Annual Report and in the white paper available on our website here.

159. How will changes made as a result of the Reference Portfolio review improve the performance of the NZ Superannuation Fund going forward?

The changes will improve the performance of the NZ Super Fund by optimising the performance of the Reference Portfolio (which has a major influence over actual Fund performance). The Guardians expects that over the long-term the Reference Portfolio will return 6.8%, 2.8% above the estimated risk free (Treasury Bill) interest rate, a proxy for the cost to the Government to contribute to the Fund.

UNDERPERFORMANCE OF REFERENCE PORTFOLIO

The Committee notes that in 2019/20, the Fund returned 1.73% compared with a Reference Portfolio return of 3.82%. Therefore, the Guardians' active investment strategies underperformed their benchmark by 2.08%:

160. What were the main reasons for this underperformance?

The major drivers were:

1) Investments in real assets (alternative energy, growth capital, infrastructure and real estate).
2) Our equity multi-factor investments under-performed broader markets.

These investments are designed to play out over the long term and short term underperformance relative to benchmarks is to be expected from time-to-time.

161. Will the Guardians be making any changes to its active investment strategies in light of this underperformance?

No. The Fund's investment strategies are designed to play out over the long term. Under-performance over a 12 month (or indeed a longer period) is not a cause for concern. Since inception in 2003, the Guardians' active investments have added $9 billion to the Fund, over and above what the Reference Portfolio has generated.

FUND CONTRIBUTIONS

The Government restarted contributing to the Fund in December 2017 with total Government contributions to the fund as at 30 June 2020 being $17.8 billion.

162. How has growth in the Fund from Government contributions affected the Fund's investment strategy and its performance?

Treasury projections show the Fund exceeding $100 billion within 10 years – roughly doubling where it stands today. As a result, we are giving considerable thought to the strategic implications of this projected growth, including for what this means for us operationally and for our ability to invest in New Zealand.

In particular, as the Fund grows, we will need to look for larger active investments in order to be sure that they will make a material performance difference. It is therefore likely that in the future we will need to increase our current minimum deal size for direct investments of $100m. We note that, in combination with the legislated restriction on the Fund owning more than 50% of an operating company, a larger deal size may be challenging to achieve in the small New Zealand market. (This scale challenge is one reason why we are interested in the light rail opportunity and are targeting large scale domestic infrastructure opportunities for investment more generally). Our current 5% Reference Portfolio weighting to New Zealand listed equities may also be challenging to maintain if the Fund grows more quickly than the market.

Other important considerations include:

- which of our current investment strategies can successfully be scaled up;
- using our increased size to unlock the ability to invest in new/different investment opportunities and/or investment products that are currently unavailable to us;
- seeking opportunities to find scale efficiencies and cost savings;
- the need to invest in people, technology and systems to support the growth that is planned.

In terms of performance, the Government has contributed $4.4 billion to the Fund since resuming contributions in December 2017. As at 28 February 2021, the Fund totalled in excess of $54 billion. We estimate that if contributions had not resumed, it would have totalled approximately $49 billion. Investment returns generated on the contributions have added an estimated $780 million to the Fund between December 2017 and February 2021. (This calculation assumes the Fund's percentage returns would have been the same and has scaled domestic tax payments down proportionately).

NZ DOMESTIC INVESTMENT

The Guardians are an important investor in New Zealand. While the total amount of its investment in New Zealand continues to grow, it is decreasing as a proportion of the total Fund.

163. To what extent is increasing the proportion of the Fund invested in New Zealand a focus for the Guardians in 2020/21?

We continue to have a strong focus on investing in New Zealand, including identifying the best strategies to increase the proportion of the Fund that is invested domestically while also meeting our commercial objectives.

New domestic investments announced during 2020/21 include:

- A commitment of $100m in New Zealand growth businesses via Pioneer Capital;
- The purchase of four vineyard sites in Marlborough from Yealands Wine Group;
- A 48% stake in New Zealand pathology business APHG (total purchase value of approximately $550 million);
- A commitment of $70m in Movac's Fund 5, investing in New Zealand technology start-ups and growth companies;
- A cornerstone investment in New Zealand's largest heavy vehicle rental and lease company TR Group;
- The acquisition of significant land holdings in Beachlands, Auckland including the Formosa Golf Course; and the ongoing development of our hotel venture with Russell Group.

While we believe there are opportunities to invest more of the Fund in New Zealand while meeting our commercial mandate, given the small size of New Zealand's capital markets and population it is important to ensure that concentration risk is appropriately managed. We note the recent performance difficulties experienced by other sovereign wealth funds with domestic-heavy portfolios, notably the Malaysian sovereign wealth fund Khazanah Nasional. See Asian Investor for more information.

164. What strategies is the Fund employing to increase the amount of investment in New Zealand?

The Guardians has significantly increased resource in its direct investment team including appointing experts to two new senior roles to add to our expertise in large scale infrastructure and real estate. We are specifically targeting these sectors as we see them as being the most likely to provide both commercially attractive returns and the scale needed to move the dial on the proportion of the Fund that is invested in New Zealand. (Indeed, our Auckland light rail proposal was a specific effort to do just that.)

165. What are the main areas/sectors proposed for investment and what are the main barriers to increasing that investment?

Detailed information about our approach to investing in New Zealand is available on our website here.

The main areas/sectors we are currently invested in are:

- Listed equities (5% Reference Portfolio weighting)
- Timber
- Real Estate
- Expansion capital (via external managers Direct Capital, Pioneer Capital, Movac, Pencarrow Private Equity and Waterman Capital)
- Rural land
- Opportunistic private equity - where we believe we can add value and the investment opportunity fits well with our investment endowments and beliefs (e.g. APHG, Fidelity Life, Kiwibank, Datacom).

As noted above, we are targeting the real estate and infrastructure sectors in particular for increased investment.

Barriers to increasing investment in New Zealand include:

- The relative size of the capital markets in New Zealand and the transactions/investment opportunities that are available;
- The legislative requirement that the Fund does not control more than 50% of an operating company (meaning we need to work alongside third party investors); and
- The large proportion of assets in local and central government ownership and a reluctance among some stakeholders to privatise these assets.

We also note that there are a range of factors influencing the proportion of the Fund that is invested in New Zealand. These include the performance of global listed markets and buy/sell investment cycles over time.

166. What have the Guardians learnt from their participation on the Auckland Light Rail initiative? How will these learnings be applied to future strategic infrastructure projects the Guardians consider involvement with?

The Fund's participation in the Auckland Light Rail initiative was our first opportunity to introduce an innovative new model for partnering on the delivery of transformational infrastructure projects to New Zealand. We continue to believe that this model has the potential to unlock intergenerational projects for New Zealand. The Fund's involvement provides a unique advantage: we allow the investment of alternative public funds into significant domestic infrastructure projects to generate financial returns for all New Zealanders.

Our participation in in the Auckland Light Rail process proved that we could mobilise expert resources and capabilities quickly and efficiently, ultimately creating a proposal submitted to the Ministry of Transport that "was considered credible and could have progressed to the next phase" and was later confirmed to be the Ministry's preferred proposal when compared to the submission by Waka Kotahi.

We undertook a detailed lessons learned exercise following this project. The key findings were:

A. We can be bold and ambitious in creating new attractive investment opportunities. Despite being "new" we succeeded in delivering a proposal that was better than what the competing experienced organisation was able to deliver.
B. We should be comfortable and flexible when working with unknowns. We need to be able to work outside our existing frameworks and be clear internally about how and why we are doing this.
C. We can be innovative, nimble, collaborative and continuously improve. An exceptionally strong team was assembled in short time, were pushed to deliver, and as a result of the constructive culture, each individual grew and had a rewarding experience.
D. Our project management skill toolbox is improving. We can learn and capitalise on the experience to better prepare for subsequent projects and continually improve these important skills.
E. Seconding key staff onto special projects creates wide ripple effects within the organisation. This needs to be carefully considered at the outset of future projects.
F. Finding the right investment partner is critical. We couldn't have achieved what we did without our partnership with CDPQ. Not only did they fill our capability gap to present a complete delivery package, but their culture, attitude and determination complemented our approach to make for an enjoyable, collaborative experience.
G. Communication is a powerful tool to generate support. Internally, the project achieved as much as it did in a large part because it had wide support from across the Guardians.

Externally, once probity restrictions were in place, we were largely unable to speak to stakeholders or contribute to the narrative.

H. Being involved in politically sensitive projects exposes us to risks beyond our control.

Our model for investing in projects like Auckland Light Rail involves partnering with Government to develop, deliver and operate infrastructure and urban development projects where a long-standing and transparent partnership is critical to success. We can provide the Government with considerable commercial and technical capability to help optimise the design and drive forward the procurement in an open and transparent long-term partnership. Public investors take an enduring interest, and invest for the intergenerational life of the assets with aligned long-term interests and objectives.

Central to our ability to innovate and deliver a world-class proposal was our ability to attract and partner with global experts, in the form of CDPQ Infra and their network of experts. For transformational infrastructure projects, New Zealand competes internationally for talent, technology and expertise so needs to set itself apart on the world stage as an attractive destination. NZSF has a role to play in this as an attractive investment partner that can provide certainty of funding and alignment of investment horizon and risk sharing to deliver better on value for money and project outcomes.

Given the Auckland Light Rail project was the first time we used our partnership model for infrastructure investing, we recognise that our approach was new to our various stakeholders. In light of this we are continuing to explain and describe our model and its application to various large-scale development projects as part of a wider communications plan. Stakeholder engagement is at the heart of large public infrastructure projects and we want to make sure our stakeholders are informed of the benefits and attributes of our approach and involvement in infrastructure investing.

The Auckland Light Rail project has had an enduring impact on the Guardians. We have demonstrated our ability to be bold and innovate, that we can bring world-leading expertise to New Zealand, and that we can find large, attractive investment opportunities to partner with Government on that can deliver on public wellbeing outcomes in addition to delivering a commercial return. Auckland Light Rail established the Guardians as an Australasian infrastructure investor of scale and we intend to apply what we learned to future opportunities and continue to build transformational projects for New Zealanders.