

**ITEM IC EXCLUSION RECOMMENDATIONS – RUSSIAN SOVEREIGN BONDS AND STATE-OWNED COMPANY SECURITIES**

**Presented by:** [REDACTED]

**Date:** 1 March 2022

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This paper has had input from CEO, CIO, PC, Legal and Communications.

**1 Purpose**

1.1 To **approve** following recommendation:

***The Guardians will exclude from the NZ Super Fund, investment in Russian sovereign bonds and in securities issued by Russian majority state-owned entities.***

1.2 Current holdings to be excluded under this decision are in Appendix 1.

1.3 The primary considerations under our Statement of Investment Policies Standards and Procedures (**SIPSP**) and Responsible Investment Framework (**RIF**) leading to this recommendation are under the categories of Sovereign Bond exclusions and Company practice (conduct) exclusions, as summarized below.

**2 SIPSP and IC delegations**

2.1 Under the Guardians' delegation framework, the CIO can authorise the Fund to:

- exclude/divest individual issuers on the recommendation of the Investment Committee; and
- determine those sovereign securities in which the Fund cannot be invested.

2.2 The SIPSP and RIF provides guidance as to the way in which we approach exclusion decisions.<sup>1</sup>

**Sovereign Bonds:**

2.3 The Fund will exclude investment in the government bonds of any nation state where:

- there is widespread condemnation or sanctions by the international community; *and*
- New Zealand has imposed meaningful diplomatic, economic or military sanctions aimed at that government.

**Company practices:**

2.4 The RIF states that in some limited cases we will exclude securities issued by companies from the portfolio. This may occur where we consider that there is an unacceptable risk that companies are involved in certain activities or breaches of standards.

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<sup>1</sup> See Page 17 of the RI Framework  
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- 2.5 We exercise judgement in making these decisions and, as relevant, take account of:
- New Zealand or other national law,
  - International law, including conventions to which New Zealand is a signatory,
  - Requirements of our mandate,
  - Significant policy positions of the New Zealand Government,
  - Impact of exclusion on expected Fund returns,
  - Actions of our peers,
  - Severity of breach/action,
  - Likelihood of success of alternative course of action (engagement),
  - Expert or other advice where relevant,
  - Other relevant factors on a case-by-case basis.
- 2.6 Other factors may include where engagement is not an efficient use of resources, considering the size of the holding and engagement effort involved.
- 2.7 The relevance of these factors in a given case, and the weight to be given to them, will vary depending on the context in which the issue has arisen. Ultimately these are matters for the Guardians to determine based on its understanding of the position, and its consideration of its mandate

### **3 International reaction to Russia's invasion of Ukraine**

- 3.1 By way of brief summary, on 21 February 2022, Russia officially recognised the two breakaway regions in eastern Ukraine, as independent states, and deployed troops to Donbas. On 22 February, the Russian Federation Council unanimously authorised the use of military force in the territories and President Putin declared the Minsk Agreements invalid. In response a number of countries began to apply sanctions.
- 3.2 On the 24 February 2022, President Putin announced that Russia was initiating a "special military operation" in the Donbas. This culminated in a full-scale invasion into Ukraine beyond the claimed independent states, including attacks on the capital Kyiv.
- 3.3 Widespread and severe international condemnation<sup>2</sup> followed swiftly. Significant economic and trade sanctions followed and have continued to escalate both in scope and in the number of countries imposing them. The sanctions have principally been directed at the Russian government, banks, those individuals considered to be close to and supportive of the Putin administration, and at Russian state-owned and military companies.
- 3.4 Russia's status as a permanent member of the UN Security Council with veto rights prevents multilateral sanctions being placed on Russia.
- 3.5 However, the General Assembly has convened an emergency special session to consider a vote which is anticipated to endorse a resolution that is similar to that which was vetoed by Russia at the Security Council which would have 'deplored in the strongest terms the Russian Federation's aggression against Ukraine'. This is a significant step to take in respect of a permanent Security

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<sup>2</sup> Joint EU-US-CA-UK Statement:  
[https://ec.europa.eu/commission/presscorner/detail/en/statement\\_22\\_1423](https://ec.europa.eu/commission/presscorner/detail/en/statement_22_1423)

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Council member, noting that only 10 such emergency special sessions of the General Assembly have been convened since 1950.

- 3.6 The feedback from experts we have received is that the level of action against a UN Security Council member is unprecedented in recent times, as is New Zealand's response.

#### 4 New Zealand Government Actions

- 4.1 The New Zealand government has issued a statement strongly condemning Russia's invasion of the Ukraine. New Zealand does not have an autonomous sanctions regimes in the way that the US, the UK and Australia do. New Zealand applies the UN Security Council sanctions to countries. Within those limits, there are measures and certain sanctions New Zealand can and is putting in place.

- 4.2 These actions include:

- Introducing targeted travel bans against Russian Government officials and other individuals associated with the Russian invasion of Ukraine, in line with a number of New Zealand's partners;
- Prohibiting the export of goods to Russian military and security forces; and
- Suspending bilateral foreign ministry consultations until further notice.

- 4.3 While the Prime Minister has stated the Government will not be looking in the first instance to review New Zealand's overall sanctions regime in the first instance. This might involve a bespoke approach to Russia restricting incoming investment flows and other asset restrictions together with other options such as expelling the Russian ambassador. Withdrawing the New Zealand ambassador from Russia, however, would leave New Zealanders in the country without ambassadorial support.

- 4.4 Our Foreign Minister condemned Russia's actions as that of a "bully", which is using its power "at odds with international law", in the United Nations meeting on 1 March,<sup>3</sup> while at the General Assembly 11<sup>th</sup> Special Emergency Meeting New Zealand's Permanent Representative to the UN H.E. Ms. Carolyn Schwalger stated "New Zealand is in no doubt that the conflict in Ukraine is a direct result of the unprovoked and unjustified actions of Russia, and its decision to flagrantly ignore international law."<sup>4</sup>

- 4.5 There has been condemnation and strong calls for action across Parliamentary parties, including for legislation allowing unilateral sanctions.

#### 5 Application of the Guardians' RI Policy and RI Framework (RIF)

- 5.1 The situation is fast evolving and complex including for investors from both a responsible investment and financial market perspective.

- 5.2 Our RIF includes the goal of avoiding prejudice to New Zealand's reputation as a responsible member of the world community – a key element of our mandate. We focus on two main types of exclusions – sovereign bonds and company specific.

- 5.3 **Sovereign bonds:** The Fund will exclude investment in the sovereign bonds of any nation state where: - there is widespread condemnation or sanctions by the

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<sup>3</sup> <https://www.stuff.co.nz/national/politics/127916002/the-blatant-act-of-a-bully-foreign-minister-nanaia-mahuta-condemns-russias-invasion-at-un>

<sup>4</sup> <https://www.mfat.govt.nz/en/media-and-resources/united-nations-general-assembly-eleventh-emergency-special-session/>

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international community; and New Zealand has imposed meaningful diplomatic, economic or military sanctions aimed at that government.

- 5.4 Our current sovereign bond exclusions apply to countries on the United Nations (UN) Security Council sanctions list, as the UN is in normal circumstances the main international sanctions body, and it also forms the basis of New Zealand's sanctions regime. Given Russia's veto power on the security council as one of the permanent members (New Zealand is actively opposed the P5 veto), we have instead looked to other international and NZ action in forming our judgement. The international response has been broad and immediate, with the EU, other European countries, UK, US, Canada and Australia all enacting unilateral sanctions.
- 5.5 The New Zealand Government's actions and public statements are meaningful within the context of our current regime in New Zealand (and this is reinforced by the Government's strong condemnation of Russia's conduct), stronger than we have seen outside the UN sanctions regime and unprecedented against a permanent UN Security Council member.
- 5.6 On this basis, we recommend the exclusion of Russian Sovereign Bonds from the Fund.<sup>5</sup>
- 5.7 **Russian state-owned companies:** Decisions on exclusion of companies (outside of product category exclusions) is based on considering a range of elements under the RIF.
- 5.8 Given the serious nature of the issues, and the pace at which the relevant matters are evolving, it is not practicable to assess in detail the conduct of the relevant companies and their proximity and association with the breach of international law by the Russian state. However, given the close association of the companies to the Russian state through its majority ownership (and other considerations outlined in this paper) we consider there is an unacceptable risk that they are involved in certain activities or breaches of standards that make exclusion the appropriate course of action under our RIF.
- 5.9 The primary elements we consider to be relevant under the RIF are:
  - New Zealand or other national law,
  - International law, including conventions to which New Zealand is a signatory,
  - Requirements of our mandate,
  - Significant policy positions of the New Zealand Government,
  - Actions of our peers,
  - Expert or other advice where relevant,
  - Other relevant factors on a case-by-case basis.
- 5.10 The Russian invasion of Ukraine breaches international law and is appropriately viewed as an act of war. Country sanctions and measures banning investors or companies doing business with or investing in a list of sanctioned Russian companies is part of a raft of economic and military measures aimed at bringing pressure on the Russian regime. These companies are targeted largely because Russian state banks and military companies are more likely to have contributed to the conflict through their direct links to the Russian Government.

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<sup>5</sup> Actual implementation faces market barriers.

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- 5.11 **Peers:** A number of peers have excluded or otherwise divested Russian securities, with Russian sovereign bonds and state-owned enterprises the main target. However, the Norwegian Government Pension Fund and the Future Fund have excluded all Russian securities.
- 5.12 The criteria relating to severe breach of UN Global Compact standards – the focus of most of our company exclusions – across all Russian companies is more difficult to ascertain based on the information currently available to us and the speed with which events are unfolding and it is less likely these companies are contributing to the conflict based only on domicile.
- 5.13 In consulting with experts, they see the strength of New Zealand's policy position, and the international measures taken, surpassing those in response to Russia's annexation of Crimea or any other permanent member of the Security Council against another.
- 5.14 On the basis of these elements under the RIF, and based on our assessment of the special characteristic of this situation, we recommend exclusion of majority Russian state-owned enterprises from the portfolio.
- 5.15 The actions of remaining Russian companies will be covered by our RIF and may be excluded in the event they are linked to the conflict and meet the threshold for conduct that would see them removed from the portfolio. As noted, this is a complex and evolving situation.

## **6 Size of holdings and Implementation**

- 6.1 Our physical exposure to Russian bonds and equities is \$9m and exclusion will not be financially material.
- 6.2 There are significant barriers to exiting Russian securities due to actions by Russia itself and liquidity issues in the investment markets as investors seek to exit Russia or are unable to trade.
- 6.3 In making the recommended policy decision, there will be a caveat that exit will depend on feasibility.
- 6.4 We will seek to coordinate our actions with the other CFIs to ensure consistency in approach. As there is significant domestic and international media interest in this matter, a joint statement will be issued in due course.

## **7 Recommendation**

- 7.1 We have assessed investments in Russian securities under our RI Policy and RIF, based on information currently available in a complex and fast evolving situation. In particular we have considered the severity of Russia's actions in the Ukraine, the strength of the international and New Zealand community response, the response of peer funds and expert advice. On this basis we believe there is an unacceptable risk that the relevant companies are involved in certain activities or breaches of standards that make exclusion the appropriate course of action under our RIF. We also consider the threshold for exclusion of Russian sovereign bonds to be satisfied.
- 7.2 We recommend the IC endorse, and the CIO approves, the following policy decision:

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***The Guardians will exclude from the NZ Super Fund, investments in Russian sovereign bonds and in securities issued by Russian majority state-owned entities.***

*(current holdings to be excluded under this recommendation are listed in Appendix 1).*

**Appendix 1.****Current Sovereign and State-owned Russian Holdings**

<b>Security Long Name</b>	<b>Security Type</b>	<b>Portfolio</b>	<b>Value (in NZ\$)</b>
Russian Federation Bonds	Sovereign	Blackrock Beta FI	1,779,960
SBERBANK OF RUSSIA	Equity	SSGA Beta Equity EM	1,756,084
SBERBANK OF RUSSIA	Equity	NTHK Upweight Equity EM	582,242
VTB BANK PUBLIC JOINT STOCK COMPANY GDR(EACH REPR 2000 ORDS)(REGS)	Equity	NTHK Upweight Equity EM	125,527
SBERBANK OF RUSSIA SPON ADR	Equity	NTHK Upweight Equity EM	351,199
GAZPROM (GAZ CAP SA) 4.95% DUE 19/07/2022	Bond	Blackrock Beta Fixed Income GA Credit	1,350,441