TITLE:

Guardians of NZ Superannuation and New Zealand Superannuation Fund

2013/14 Review

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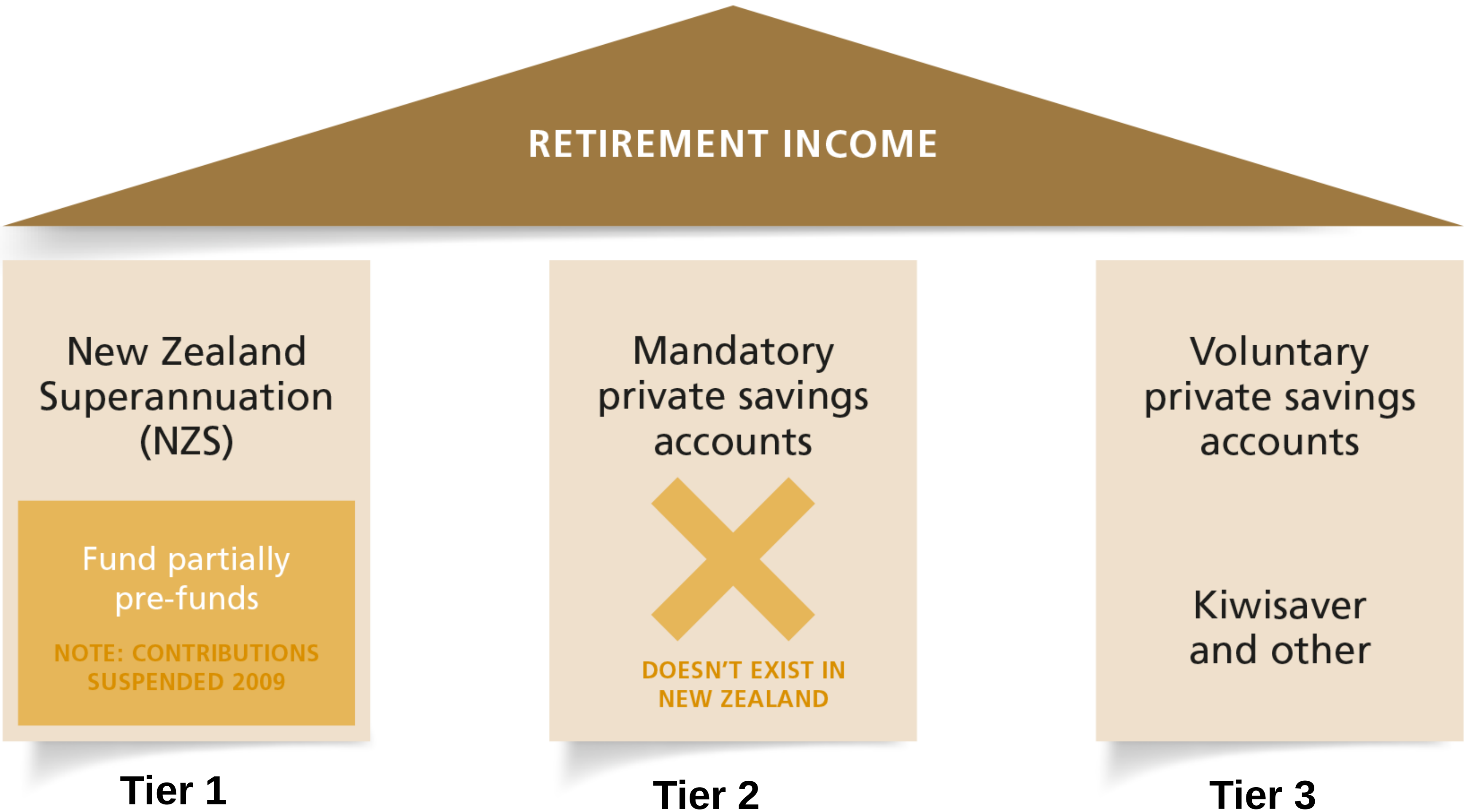
EVENT | PRESENTATION:

Commerce Select Committee, 26 February 2015

Agenda

- Our role and mandate
- Investment approach
- Benchmarking
- Performance
- Outlook
- NZ Superannuation and Retirement Income Amendment Bill

Where we fit in – part pre-funding tier 1

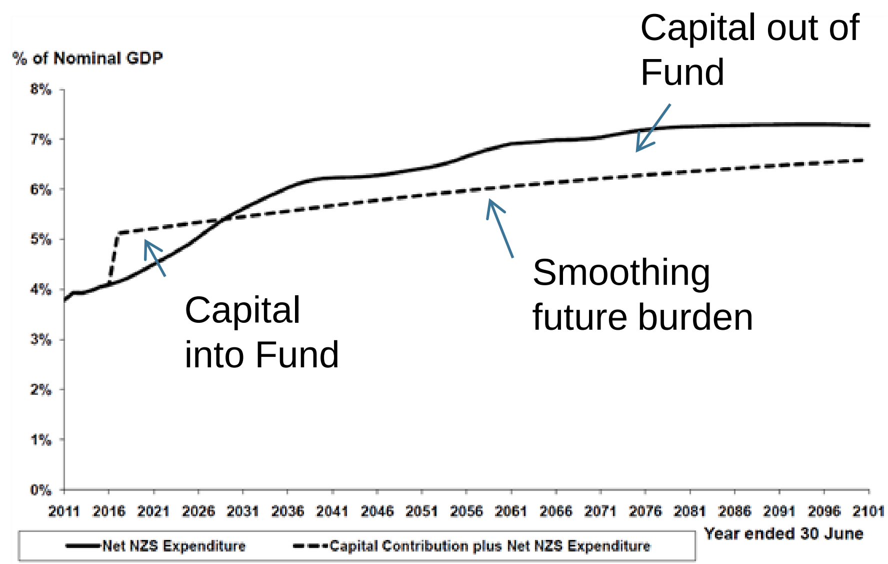


What we do and how

New Zealand Superannuation Fund - Overview

- Long-term savings vehicle to partially meet the rising future cost of New Zealand Superannuation
- Commenced investing Sept 2003
- Enabling legislation - *New Zealand Superannuation and Retirement Income Act 2001*
- Double-arms'-length autonomous Crown entity
- Contributions suspended 2009; estimated to re-start 2020/21 or when net debt is below 20% of GDP

Save Now – Support Future



NZ Treasury Graph

Mandate, Mission and Vision

- **Mandate** (as per the Act):
  - The Guardians must invest the Fund on a prudent, **commercial** basis and, in doing so, must manage and administer the Fund 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.
- **Mission**:
  - ‘Maximise the Fund’s return over the **long term**, **without undue risk**, so as to reduce future New Zealanders’ tax burden’
- **Vision:**
  - ‘A great team building the best portfolio’

The Fund's advantages as an investor:

Long Horizon	Certainty of Liquidity	Operational Independence	Location & Crown Owner

- We can ride-out short term market movements
- Genuine contrarian investor
- We can invest in private market and illiquid assets
- We pay lower tax in some jurisdictions (sovereign status)
- Favourably regarded as a potential co-investor and business partner

- We achieve this by relying on our investment beliefs

Investment approach

We look to fully 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 ➡ best chance of success
  - First capital withdrawal not until 2029/30
  - Strong weighting towards growth assets (which can be volatile over the short term)
- Principles of long-term investment:
  - A clear purpose
  - Discipline and capacity to stay the course
  - Transparency and clear communication to stakeholders
  - Focus on best practice management of environmental, social and governance factors

Why we use direct investing

- To have greater influence over the allocation of our capital to different investment risks
- To provide access to opportunities which we can’t access through public markets
- To maximise returns (e.g. remove external manager fees)
- To improve Fund diversification
- To avoid agency risk which exists with external managers, particularly in relation to strategies that exploit our long horizon endowment
- We only invest directly where we have the capability in-house, and it will be cost-effective to do so

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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** by the Guardians."
  - "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 2014, $3.8 billion invested in NZ compared to $2.8 billion as at 30 June 2009
- Have now executed full investment cycle – originate, transact, improve, exit
- We continue to investigate opportunities to invest locally, while ensuring the Fund is appropriately diversified geographically and across asset classes, and maintaining price discipline
- Resource in the NZ Direct team has been increased with the objective of taking more deals to due diligence

Benchmarking

We have chosen to benchmark against best practice industry principles and measures and relevant global peer funds

<table>
<tr><th></th><th>Internal measures and mechanisms</th><th>External measures</th><th>Stakeholder engagement</th></tr>
<tr><td>Cost structure</td><td>By business unit
By investment opportunity
Holistic view of fees</td><td>CEM Benchmarking
Hay remuneration database</td><td rowspan="6">Peer fund engagement:
• 3Cs: comparison, collaboration and co-investment

Global expertise</td></tr>
<tr><td>Governance</td><td>Reference Portfolio Review
Internal Audit</td><td>Independent Reviews ‘04, ’09, ‘14
OAG special performance audit (‘08)
SWF GAAP
Select Committee Reviews</td></tr>
<tr><td>Performance</td><td>NZ T Bill rate + 2.5%
Reference Portfolio + 0.5%</td><td>Performance against both measures published monthly</td></tr>
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OIA</td><td>Sovereign Wealth Institute’s Transparency Index</td></tr>
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<tr><td>Risk</td><td>Risk Committee Reviews
Risk Records & Registers
Investment Risk Limits
Target Liquidity Level</td><td>CEM Benchmarking</td></tr>
</table>

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Performance as at 31 January 2015

Fund size breakdown	Last 5 years	Since inception
Contributions received	$0 billion	$14.88 billion
Returns (after fees and foreign tax, and before NZ tax)	$14.54 billion	$17.00 billion
NZ tax (paid) / received*	$(3.06) billion	$(4.43) billion
Other movements**	$0.02 billion	$0.03 billion
Closing Fund balance as at 31 December 2014	**$27.47 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

Performance vs. benchmarks	Last 5 years	Since inception
Actual Fund Returns (after costs, before NZ tax)	**15.51% p.a.**	**9.98% p.a.**
vs. Reference Portfolio Return	Exceeded by 3.15% p.a. ($3.9 billion)	Exceeded by 1.14% p.a. ($3.3 billion)
vs. Treasury Bill return	Exceeded by 12.84% p.a. ($13.1 billion)	Exceeded by 5.33% p.a. ($11.6 billion)

Benchmark 1: Passive Reference Portfolio return (the best passive, listed "market" return that would achieve the Fund's objectives over time)
Benchmark 2: Treasury Bill return (a measure of the cost to the Government of contributing to the Fund instead of paying down debt)

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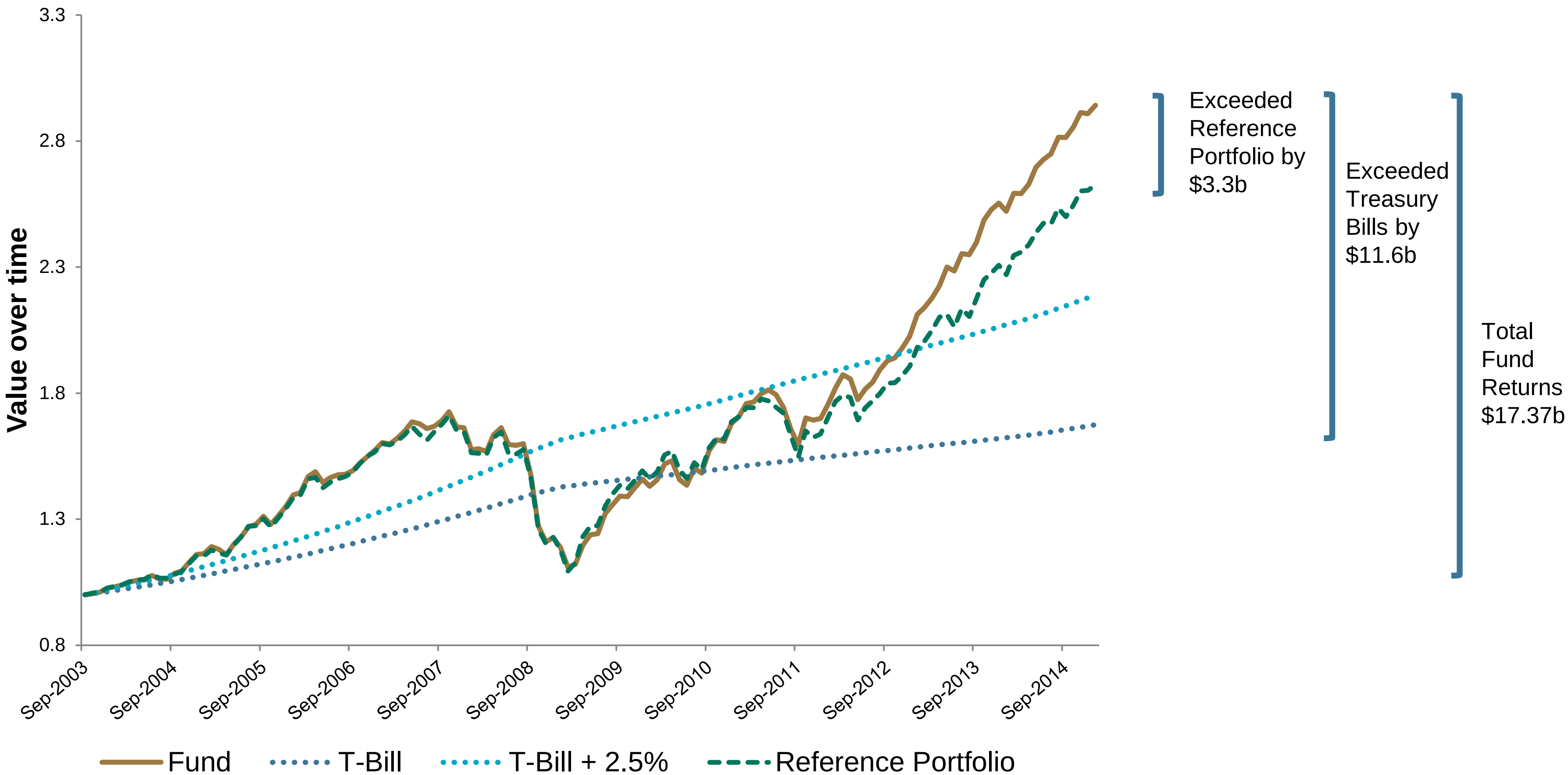
Performance vs. Benchmarks



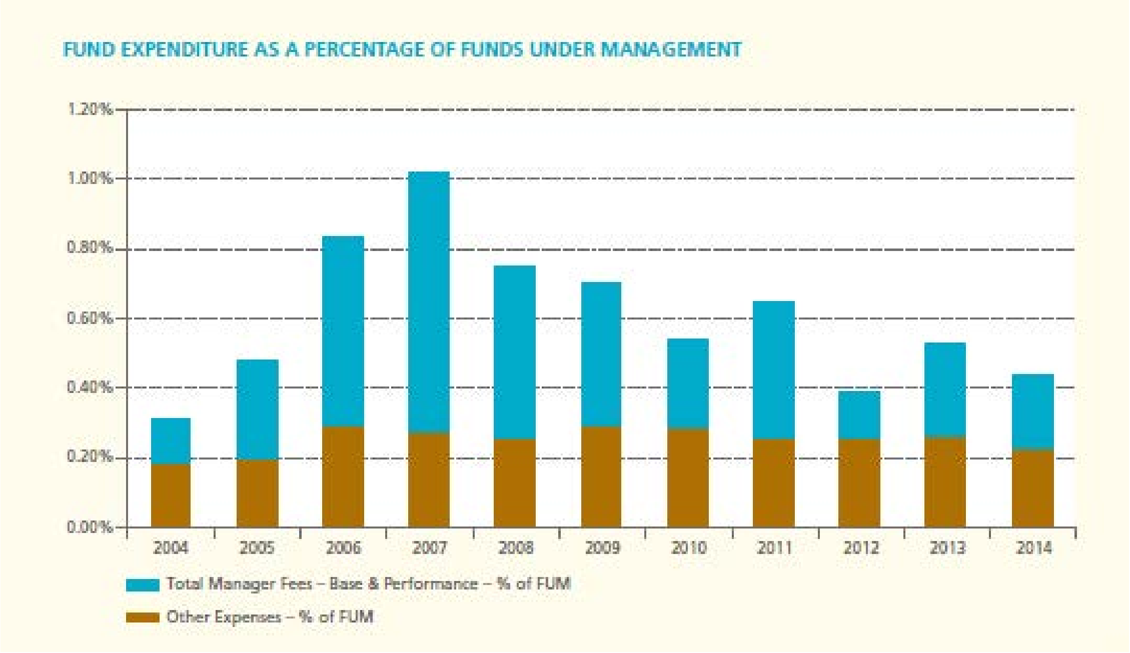
Performance vs. Benchmarks - cost

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

- 2013 calendar year CEM annual **cost-effectiveness** survey of more than 300 funds:
  - the NZ Superannuation Fund's net five-year value-add of 2.2% was above global and peer medians
  - The NZ Superannuation Fund's five-year costs were lower than the median costs for similar funds

Cost Control

The Fund's overall expenses reduced from the prior financial year, driven primarily by a deliberate reduction in manager fees and advisor costs, offset by increased performance fees and personnel costs (in-sourcing decision-making).



Figures as at 30 June 2014

Independent Review

Promontory Financial Group conducted the five-year independent review of the Guardians during 2014

- Promontory appointed by Treasury with Terms of Reference set by Minister of Finance
- Report provides independent confirmation that the Guardians' overall investment approach is consistent with best practice by international sovereign wealth funds
- It also recognises the progress that has been made by the Guardians since the last independent review in 2009
- Report notes that *"the Guardians are among a minority of global professional fund managers who have been successful in adding substantial value about their benchmarks over a sustained period of time."*
- Promontory made a number of useful suggestions and recommendations that are being worked through
- Full details available on our website

Global peer engagement

- Active membership and leadership of influential global forums
- Systematic programme of co-investments with peers
- Regular exchange of best practice and wider benchmarking
- Setting global standards where relevant
- Hosting the International Forum of Sovereign Wealth Funds in New Zealand in 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 are operating at global best practice standards

Outlook

- Over the long term we expect average returns of 8% - 9% a year, based on current portfolio settings
- Fund continues to be strongly weighted to growth assets – we are prepared to weather short-term volatility for a better long-term return
- With many asset classes globally nearing or above full value, and economic growth patchy globally, it is becoming harder to find good investment opportunities
- 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
- The Fund's 'endowments' – long-term horizon, certain liquidity, operational independence and Crown ownership – give it important advantages as an investor

NZ Superannuation and Retirement Income Amendment Bill

- We requested the changes included in the Bill and have worked closely with officials to ensure they are fit for purpose
- The Bill enhances our ability to discharge our duties and achieve our statutory objective – to maximise returns without undue risk
- Allowing the establishment and control of investment vehicles will enable the Guardians to structure and access investments more efficiently and provide protection from disproportionate liability
- The Guardians will continue to be prevented from holding or taking controlling interests in any underlying operating entity