

5 May 2014

Clerk of the Committee
Finance and Expenditure Select Committee
Parliament Buildings
WELLINGTON

Dear Sir / Madam

**NEW ZEALAND SUPERANNUATION AND RETIREMENT INCOME AMENDMENT BILL
(No.166-1)**

The following submission on the New Zealand Superannuation and Retirement Income Amendment Bill (No.166-1) ("the Bill") has been prepared by the Guardians of New Zealand Superannuation ("the Guardians"). The Guardians manages and administers the New Zealand Superannuation Fund ("the Fund").

Executive Summary:

1. The Guardians supports the changes proposed in the Bill and has worked closely with Government officials to ensure they are fit for purpose.
2. The amendments included in the Bill will enhance our ability to discharge our duties and achieve our statutory objectives.
3. Allowing the Guardians to establish and control investment vehicles will enable the Guardians to structure and access investments more efficiently and will help protect the Guardians from disproportionate liability.

Background:

4. The Fund is a Government savings vehicle established to partly pre-fund the future cost of New Zealand superannuation payments and therefore reduce the burden of the cost of superannuation on future generations of New Zealanders. The Guardians has operational independence regarding its investment decisions.
5. Since the inception of the Fund in September 2003, the Government has contributed NZ\$14.88 billion to it. As at 31 March 2014, a period of 10½ years, the Fund has returned 9.49% p.a. (after cost, before NZ tax). After paying NZ tax during this period of \$3.89 billion, the Fund is now NZ\$25.19 billion in size.
6. Highly diversified across geographies and asset classes, the Fund has investments around the world in listed equities, private companies, timber, property, infrastructure, insurance-linked products and farmland.

7. The Guardians is recognised internationally for its governance, transparency, innovation and commitment to responsible investment. For further information on the Guardians and Fund see our website at www.nzsuperfund.co.nz.

General:

8. We requested that these changes be made to our legislation and are very supportive of them. We would like to acknowledge the support of the Minister of Finance and his officials in relation to this Bill.
9. The Guardians has worked very closely with Treasury, and the Policy and Strategy Division of Inland Revenue, in agreeing the format and wording of the changes.
10. The amendments included in the Bill will enhance our ability to discharge our duties and achieve our statutory objectives contained in section 58 of the New Zealand Superannuation and Retirement Income Act 2001 (“the Act”) i.e.
 - (1) *The Guardians are responsible for investing the Fund.*
 - (2) *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 –*
 - a) *Best-practice portfolio management; and*
 - b) *Maximising return without undue risk to the Fund as a whole; and*
 - c) *Avoiding prejudice to New Zealand’s reputation as a responsible member of the world community.”*
11. We note that the detailed explanatory note to the Bill, the Bill digest and the Treasury disclosure statement (dated 17 October 2013) are comprehensive and contain further background on the Bill. Our specific comments on the Bill, as set out below, should be read in conjunction with these documents.

Fund Investment Vehicles:

12. The Bill’s primary purpose is to facilitate the efficient and effective investment of the Fund by allowing the Guardians to control entities formed for the purpose of holding, facilitating, or managing the investments of the Fund (i.e. Fund investment vehicles (“FIVs”).
13. The purposes for which the Guardians will use FIVs include:
 - Investing entities for non-controlling equity stakes in entities and investment funds:
 - Internally or externally managed funds investing in non-controlling equity stakes, debt instruments, commodities, financial derivatives, and other investment securities:
 - Investing entities for real property assets (e.g. timber, farming, and investment property assets).
14. The Guardians will continue to be prevented from holding or taking substantial controlling interests in any underlying operating entity, such as through takeovers of listed companies or acquisitions of majority stakes in unlisted entities.

15. An appropriate governance framework for the implementation and operation of FIVs will be detailed in the Guardians' Statement of Investment Policies, Standards, and Procedures (SIPSP), available on www.nzsuperfund.co.nz once the Bill is passed into law
16. Allowing the Guardians to establish and control investment vehicles will enable the Guardians to structure and access investments more efficiently and will help protect the Guardians from disproportionate liability.
17. This will give the Guardians greater ability to implement specific mandates for the Fund (as opposed to being one of a number of investors in a pooled fund).
18. FIVs have a number of benefits, including :
 - a) by enabling the Guardians to negotiate a specific mandate with a manager (as opposed to being one of a number of investors in a pooled fund), giving us a greater ability to negotiate specific terms such as those we might wish to apply in line with our Responsible Investment Framework. A copy of this Framework is available on www.nzsuperfund.co.nz;
 - b) giving us more say over the jurisdiction in which the investment vehicle is located (which we will make following an assessment of factors including reputation, tax, legal, regulatory and operational concerns); and
 - c) giving us more flexibility to increase and reduce the level of a particular investment over time.
19. The current Section 59 restriction, which prohibits the Fund from investing in wholly or majority owning entities, has resulted in the Fund being unable to pursue a number of attractive specific investment opportunities. These include:
 - a) investments in various investment funds which could not be made as the investment fund would have been deemed under accounting standards to be controlled by NZSF;
 - b) committing to new investment strategies because we would have had to initially take a controlling stake in an investment fund to enable the initiative to proceed;
 - c) acquiring shares in special purpose holding companies which held a non controlling strategic stake in an operating company; and
 - d) special purpose, NZSF-specific funds mandates.

Other more expensive and inefficient options are usually available to access these classes of investment opportunities. The proposed amendments will not change the universe of investment classes available to GNZS. The ability to control FIVs will, however, improve the options available for accessing and structuring fund investments, delivering cost efficiencies and better risk management.
20. The Section 59 restriction has also meant the Fund has incurred a range of costs. A conservative estimate of these costs and missed investment outcomes to date is approximately NZD30m.

Use of funds, companies and other investment vehicles based in tax neutral jurisdictions:

21. The Guardians' position in relation to the use of funds, companies or other vehicles located in tax neutral jurisdictions is as follows:

The Guardians has a comprehensive tax risk management framework designed to ensure that the Fund meets its worldwide tax obligations. The Guardians does not invest the Fund in schemes or arrangements that use secrecy laws to conceal assets and income that are subject to tax, or which create false tax deductions.

The Guardians requires funds, companies and other vehicles in which it invests to provide full tax transparency and information exchange for tax purposes, and compliance with all relevant laws.

The use of such funds is a common and legal practice among institutional investors such as the Guardians. It is widely considered best-practice portfolio management. In most cases, non-US resident investors such as the Fund would not be able to access these investments without using an investment vehicle.

22. By way of background, the Fund pays tax at source on the underlying investments within the investment fund (i.e. US tax is paid on an underlying US investment). The investment fund then provides a tax-neutral jurisdiction to ensure that the aggregated collective income is not subjected to an additional layer of foreign tax. New Zealand income tax is then paid by the Fund on income from the investments. Unlike most sovereign wealth funds the Fund also pays income tax in its home country, New Zealand. Without the use of tax neutral jurisdictions the income could be taxed three times rather than twice. As noted above, use of investment funds in tax neutral jurisdictions is a common and legal practice.
23. As at 30 June 2013 approximately 7% of the Fund was invested in via tax-neutral jurisdictions. The Fund holds investments in investment vehicles domiciled in the Cayman Islands, Isle of Man, British Virgin Islands and Mauritius.
24. The IRD is aware of the Fund's investments in the above investment vehicles. (The Guardians has a Co-operative Compliance Agreement with Inland Revenue. Both Parties consider this relationship to be transparent, constructive and trusted). We note that New Zealand has signed tax exchange of information agreements with the majority of these jurisdictions.
25. We note comments in the House by the Green Party indicating that it does not support the Bill because it considers that it gives the Fund more flexibility to invest via tax-neutral jurisdictions.

As outlined above, the Guardians already has the ability to utilise tax-neutral jurisdictions to invest the Fund, within the parameters of its tax risk management framework. The Bill does not change this situation, nor does it make it any more likely that the Guardians will invest via these jurisdictions. We note the Fund pays all applicable taxes on its investments at source, and also pays tax on the income from all of its investments in New Zealand. Tax-neutral jurisdictions remove the need to pay a third layer of tax on the same income, when investing in an investment fund


alongside other investors. This reduces unnecessary tax leakage and maximises the returns to the Fund which ultimately reduces the burden on future New Zealand taxpayers.

Other Matters included in the Bill:

- a) Clarification that the Fund is an integral part of the Crown and not a corporate entity. This is to ensure that the Fund' sovereign tax status is respected by Foreign Tax Authorities.
- b) Allows the Guardians Board to delegate to management the power to appoint Managers and Custodians and grant power of attorney. This removes the costs of individual approval process and will improve timeliness and efficiency. The Guardians Board will still choose to reserve some critical decisions to itself, for instance the decision to appoint a master custodian.
- c) Protecting the Guardians against claims that acts of the Guardians are invalid i.e. "Ultra vires" on the grounds that they are contrary to, or outside the authority conferred by any Act. This enables Guardians, and parties transacting with the Guardians, to transact with confidence.
- d) Amending the tax rules to allow for Guardian controlled FIVs enables us to group our income streams in an efficient tax manner for operational purposes.

The Guardians would welcome the opportunity to make an oral submission to the Committee on our submission.

Yours sincerely



Gavin Walker
Chair
Guardians of New Zealand Superannuation

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