C3 - Restricted Confidential

NEW ZEALAND SUPERANNUATION FUND

2 June 2009

Hon Bill English
Minister of Finance
Parliament Buildings
WELLINGTON

Dear Mr English

This letter, pursuant to section 64(6) of New Zealand Superannuation and Retirement Income Act 2001 (the Act), sets out how the Guardians of New Zealand Superannuation propose to have regard to your direction of 14 May 2009.

We acknowledge that your direction is 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".

We also note your clear statement that our actions in regard to your direction must be consistent with our duty to invest the Fund on a prudent, commercial basis, in accordance with section 58(2) of the Act.

Investing in line with section 58

Investing to maximise returns, without undue risk, in a manner consistent with best practice portfolio management requires that we consider returns on potential investments in the context of their long-term impact on the risk profile of the Fund as a whole.

In considering a substantial allocation to New Zealand assets, the Fund will expect an additional return (when compared with more diversified global investments) to reflect the risks associated with asset concentration, the relative illiquidity of New Zealand assets, and other relevant idiosyncratic risks associated with investing in any single location.

New Zealand Investments

The Fund already has significant investment in New Zealand (18% of the Fund or 27% including cash) that goes well beyond New Zealand's weight in the global investment market. This reflects our ability to achieve the additional expected investment return required here as a result of our comparative advantage in accessing NZ opportunities.

In earlier correspondence we discussed our allocation to each investment sector and the commercial and practical constraints on increasing exposure to some sectors in New Zealand. The Fund's exposure to property, forestry and the listed equity market are already high. We also continue to explore lifting private equity investment, although the scale of

GUARDIANS OF NEW ZEALAND SUPERANNUATION
Level 17, Quay Tower, 29 Customs Street West, Auckland
PO Box 106 607, Auckland, New Zealand. Phone: +64 9 300 6980 Fax: +64 9 300 6981
www.nzsuperfund.co.nz

suitable opportunities is not likely to make a substantial difference to the Fund's overall New Zealand weighting. The Fund has one large infrastructure investment in New Zealand and has sought other suitable opportunities in this area.

Opportunities

The current economic climate is leading to higher prospective returns for illiquid assets and less competition from investors in NZ assets, including reduced competition from overseas investors. It is therefore possible, while this climate persists, that opportunities will arise which will attract the additional return that the Fund is seeking to compensate for an increased concentration in New Zealand.

Some of these opportunities will be large and relatively infrequent. Our ability to maximise some opportunities may also be constrained by Section 59 of the Act. This section states the Guardians must use their best endeavours to ensure that the Fund does not control an entity. Our letter of 18 February outlined desirable changes to the Act to manage this issue.

All such potential investments will require the Fund to ensure it has access to expert investment management capability to assess the opportunity and manage future monitoring, oversight and, when appropriate, realisation.

The Fund normally appoints external investment manager experts in each particular investment sector. Before appointing managers the Fund goes through an extensive process to establish a high conviction in that manager's competence, competitive advantage, and alignment with the Fund's objectives. If no manager meets the high conviction hurdle then no manager is appointed. The New Zealand investment management market is not deep and hence securing appropriate investment managers is not guaranteed. The Fund is therefore likely to establish in-house expertise in order to assess some opportunities.

We will investigate whether we can establish new management arrangements in selected areas, including small-to-medium sized infrastructure opportunities, and the provision of recapitalisation and expansion capital facilities for NZ companies.

We may, subject to suitable opportunities arising, explore rural and land based investment, investments with State Owned Enterprises, and larger infrastructure investments. There is, of course, limited access to these opportunities

Expectations

The directive in your letter of 14 May is prefaced with the background objective of eventually aiming at a target of 40% of the Fund being invested in New Zealand, with the anticipated benefits being an increase in investment in our productive sector, promoting infrastructure investment and contributing to the further development of our capital markets.

Given the unpredictable nature of future commercial, prudent, investment opportunities, we are unable to offer an assurance as to how much, if at all, the Fund's New Zealand assets will increase. Much will depend on the frequency and scale of such commercial opportunities, and our confidence in satisfactory investment arrangements. To guarantee an increase to a prescribed percentage would require a modification to the Fund's commercial objectives under section 58(2) of the Act.

In addition, while local investment activities may produce positive benefits (externalities) in assisting developing New Zealand's capital markets, we can not take these externalities directly into account when making an investment decision under our current Act.

Having regard to your direction

We will have regard to your directive by:

- Actively considering those investment opportunities in New Zealand that offer prospective terms and conditions that meet the criteria under section 58(2) of the Act; and

- Seeking to identify methods of assessing and managing investments in the areas of opportunity outlined above.

Pursuant to section 64(7) of the Act, we look forward to reporting on our progress in our Annual Reports from this year's document onward. We will also provide progress updates via our quarterly report to you.

Yours sincerely

David May

David May
Chairman

Adrian Orr
Chief Executive Officer