

# NEW ZEALAND SUPERANNUATION FUND

## INTRODUCTION TO GUARDIANS AND FUND



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## **Preface**

Welcome to this Introduction to the Guardians of New Zealand Superannuation and the New Zealand Superannuation Fund. This is a unique organisation with a unique role, both nationally and globally. We have a strong and committed team and an important job – to reduce the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation (NZS).

NZS is the retirement benefit paid to all eligible New Zealanders by the New Zealand Government. As the benefit is Government policy rather than a contractual arrangement, the Fund has no explicit liabilities; is therefore invested on an absolute return basis and, with 100% Government ownership, is characterized as a Sovereign Wealth Fund.

Our purpose means that we are working for all New Zealanders, including those more than a decade away from being born.

To be specific; according to current retirement policy and New Zealand Treasury funding forecasts:

- The first New Zealanders to have part of the cost of their New Zealand Superannuation met from the Fund<sup>1</sup> are currently aged 44.
- The size of the Fund is not expected to peak until today's 19-year-olds are eligible to retire in 2056.
- The size of the Fund will still represent more than 17% of New Zealand's GDP in 2090, when retirement eligibility arrives for New Zealanders who won't be born for 15 years (in 2025).

These are the people, and this is the time frame, underpinning everything we do at the Guardians to administer and manage the pool of assets called the New Zealand Superannuation Fund.

The purpose of this introduction is to provide a good grounding in the Guardians and in the Fund, for anyone interested in our organisation. It tells you something about who we are and how we do things and sets out the parameters within which we must operate; our founding legislation and our statutory duties.

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<sup>1</sup> According to current Treasury forecasts and retirement policy relating to eligibility for and 'generosity' of New Zealand Superannuation

## The Basics

### *Who we are*

Fundamentally, the New Zealand Superannuation Fund is a pool of assets. The Guardians of New Zealand Superannuation is the organisation set up to manage the pool of assets. Both the Fund and the Guardians were established under the New Zealand Superannuation and Retirement Income Act 2001 (the Act). You can read more about the Act on page 9.

### *What we believe in*

**Our Vision:** A great team building the best portfolio

**Our Mission:** To maximise returns without undue risk over the long term so as to reduce future New Zealanders' tax burdens.

Our Values and Investment Beliefs are set out on pages 6-7.

### *What we do*

The purpose of the *Fund* is to reduce the tax burden on future taxpayers of the cost of New Zealand Superannuation (NZS), which is the retirement benefit paid by the New Zealand Government to all eligible New Zealanders when they reach 65.

In the next section we describe how that works but, in essence, the Fund serves its purpose by assisting the Government to meet the cost of NZS.

The purpose of the *Guardians* is to manage and administer the Fund. Specifically, the Act states that 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;
- (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.

## We have nothing to do with Kiwi Saver

The New Zealand Superannuation Fund is entirely separate from Kiwi Saver.

Kiwi Saver is a scheme by which New Zealanders save, into individual accounts, for their own retirement and with some Government assistance. It is offered by a number of different investment managers, but the Fund is not one of them

The role of the Fund is to help meet the future cost of New Zealand Superannuation (NZS), which is the Government provided retirement entitlement paid to all qualifying New Zealand residents.

All New Zealanders who meet the eligibility criteria for NZS will receive it from the age of 65.

## We do not pay nor do we determine eligibility for New Zealand Superannuation

This is the responsibility of Work and Income New Zealand (0800 552 002 or direct queries to: <http://www.winz.govt.nz/individuals/65-years-or-older/>)

The Fund's relevance to NZS is to contribute to the cost of paying out that entitlement in the future (a consequence of this, is that less taxation has to be imposed on future taxpayers to meet that cost). We do this by investing Government capital contributions and by reinvesting the returns we make from those investments. However, while the Fund helps meet the cost of the payments, the actual source of them is Work and Income New Zealand.

## Why we exist

As we've said, the purpose of the New Zealand Superannuation Fund is to reduce the tax burden on future taxpayers of the cost of New Zealand Superannuation (NZS). But what is the reason for that purpose?

Because Government projections show that between 2005 and 2050 the number of New Zealanders eligible to retire (aged 65+) is expected to double and the associated cost of providing their retirement income – NZS – is also expected to double.

This is important because not only will there be more New Zealanders aged over 65: they will also increase as a *proportion* of the population through and beyond the 2005-2050 period. This is because New Zealanders as a whole are not having enough children to maintain the current weighting of 'working age' people i.e. those aged 15-64 through the same period.

This means there will be less 'working-age' people whose productivity can be tapped (through taxation) to fund not only NZS for a greater number of people than ever before in New Zealand's history, but also Government expenditure on health, education, law enforcement and other vital core services. This is therefore a situation which is relevant to you and to future generations.

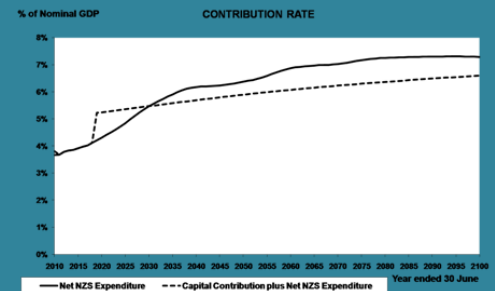
## How does the Fund work?

The creation of the Fund recognises the situation set out above as a significant, multigenerational, social and financial challenge.

It attempts to address this situation by 'smoothing' the tax burden between generations of the future cost of New Zealand Superannuation (NZS). It does this by investing Government contributions received during the early period of the Fund and, through returns generated over decades of investing, by growing the size of the Fund.

At a certain point – currently from 2031 – the Government begins making withdrawals from the Fund to help to meet the cost at that time of NZS (which, as we've said, is expected to have significantly increased).

On this page and next are graphs, produced by the New Zealand Treasury, showing projected contributions and withdrawals and the impact they are expected to have on the size of the Fund over time (we note the graphs are derived from 2009 Budget Estimates and will change as the estimates do).



The solid line shows the projected cost of New Zealand Superannuation absent the existence of the Fund. The dotted line shows the projected cost after allowing for contributions into (withdrawals from) the Fund.

The difference (the 'gap') between the two lines shows the amount of the projected contribution (withdrawal) in any one year.

'Pre-funding' the future cost of NZS in this way means that future Governments will not have to seek as much from future New Zealand taxpayers (or from other sources, such as raising debt) to meet the cost of NZS when it is increasing most sharply.

By investing in the Fund the Government has taken the decision that, over the longer term, it will earn more in investment returns on Fund contributions than it will save in debt servicing. As a result, the Government will be in a better position to deal with increased Superannuation liabilities when they arise.

### Beliefs and values

The Fund benefits from a number of important endowments, as follows:

- our long investment horizon
- our tolerance for illiquidity
- our Sovereign status

The combination of these factors optimises our chances of investment success.

We also have a set of firmly held investment beliefs which inform all of our investment strategies and draw on our endowments. The beliefs are set out on the following page.

#### Values

We have developed, and are embedding a set of organisational values. These are:

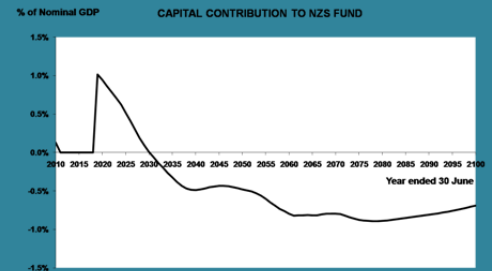
**Inclusiveness** – We combine diverse skills, and seek relevant views and rigorous analysis, in a supportive environment.

**Innovation** – we encourage initiative and continuous learning and drive timely decisions.

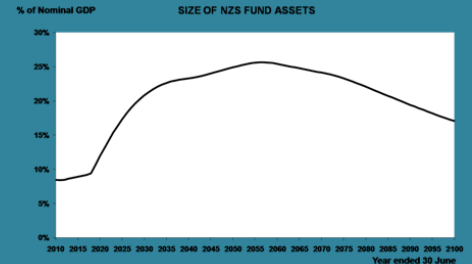
**Integrity** – we behave consistently with a transparent and commercial manner for the long-term benefit of the Fund.

#### Investment Beliefs

Our Investment Beliefs set out in the table on the following page underpin the way we choose to invest the Fund. All our investment decisions are grounded in these beliefs.



The black line in this chart shows the profile over time of Government contributions to the Fund. Consistent with the Budget announcement, the line is flat until 2020. It then 'spikes' as contributions are resumed, with initial contributions required to 'make up' for the 11 years in which none were made. From 2031 withdrawals begin, when the line dips below zero.



The black line in this chart shows the projected size of the Fund over time. It peaks at 22.65% of GDP in 2057 (when today's 18-year-olds will be eligible to retire).

<b>Investment Decision</b>	<b>Investment Beliefs</b>	<b>Investment Facts</b>
<b>Governance and investment objectives</b>	Clear governance and decision-making structures that promote decisiveness, efficiency and accountability are effective and add value to the Fund.	It is important to be clear about investment objectives for the Fund, risk tolerance, and the timeframe over which results are measured
<b>Asset Allocation</b>	<p>Asset allocation is the key investment decision</p> <p>Investors with a long-term horizon can outperform more short-term focused investors over the long-run</p>	<p>Risk and return are strongly related.</p> <p>There are varied investment risks that carry premiums/compensations. Illiquidity risk is one such premium.</p> <p>Investment diversification improves the risk to return (Sharpe) ratio of the Fund</p>
<b>Asset class strategy and portfolio structure</b>	Expected returns are partly predictable within asset classes and returns can revert toward a mean over time.	<p>Investment markets are competitive and dynamic, with excess returns very difficult to find and constantly changing source</p> <p>Market volatility tends to cluster over short horizons but mean-reverts over longer horizons.</p> <p>Investment risks can be unbundled to make the Fund more efficient. This includes the separation of market (beta) and investment specific investment manager skills (alpha).</p>
<b>Manager and investment selection</b>	<p>True skill in generating excess returns versus a manager's benchmark (i.e. pure alpha) is very rare. This makes it hard to identify and capture consistently.</p> <p>Some markets or strategies have characteristics that are conducive to a manager's ability to generate excess return</p> <p>These characteristics tend to evolve slowly over time, although the shorter-term opportunity set that may be available in any market/strategy can vary through the cycle.</p> <p>We believe most excess return is driven by a combination of the research signals the manager is using, the conduciveness of their market to generating excess returns, beta factors and luck.</p> <p>Responsible asset owners who exercise best-practice portfolio management should have concern for environmental, social, and governance (ESG) issues of companies</p> <p>Improving ESG factors can improve the long-term financial performance of a company</p>	<p>The more efficient a market is, the more difficult it is for a manager to generate excess return.</p> <p>Research signals and methods used by managers tend to commoditise over time through market forces</p> <p>In some cases synthetic exposure to a market or factor can provide a guaranteed excess return to the Fund, and this represents an additional hurdle that an active manager must surpass.</p>
<b>Execution</b>	Managing fees and costs and ensuring efficient implementation can prevent unnecessary cost	

## **Governance**

The Guardians is overseen by an independent Board appointed by the Governor-General on the recommendation of the Minister of Finance.

The Minister's recommendation follows nominations from an independent nominating committee. On receiving those nominations, the Minister must consult with representatives of other political parties in Parliament before recommending the Governor-General appoint a person to the Board. Board members are chosen for their experience, training, and expertise in the management of financial investments.

The Board must comprise of at least five, but no more than seven, members. Each Board member is appointed for a term of up to five years and is eligible to be reappointed. The first Board members were appointed in August 2002.

### *Arm's-length operation*

While accountable to the Government, the Guardians operate at arm's length from the Government. We are required to report on the Fund to the Minister of Finance as required by the Minister – currently this is quarterly and takes the form of a written report on the Fund's progress.

Under our governing Act (see next page), the Minister of Finance may give directions to the Guardians regarding the Government's expectations as to the Fund's performance, including its expectations as to risk and return. However, the Minister may not give any direction that is inconsistent with the duty to invest the Fund on a prudent and commercial basis.

The Guardians must have regard to any such direction, and must notify the Minister how they propose to do this, as well as report any direction in the Annual Report. Directions given by the Minister must be tabled in Parliament.

To date we have received one direction from the Minister, which is published on our website along with our response. We publicly disclose investment activity relevant to the direction in our Annual Report.

### *Key legal elements*

The key legislation governing the powers and purpose of the Guardians and the duties of the Board is the New Zealand Superannuation and Retirement Income Act 2001 (Act) and the Crown Entities Act 2004 (CEA). These Acts are available via our website. The Guardians is an autonomous Crown Entity under the CEA.

The Act establishes the Guardians and the Fund. The Act's key provisions are:

- Restrictions on borrowing (Section 50) – The Guardians' ability to borrow, mortgage or incur contingent liabilities is restricted. Minister's consent is required.
- Investment Duties (Section 58) – The Fund must be managed on a prudent, commercial basis, consistent with:
  - (a) best-practice portfolio management;
  - (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
- No controlling interests (Section 59) – Guardians to use best endeavours to ensure the Fund does not obtain a controlling interest in any other entity.
- Investment policies (Section 60) – Guardians must establish and comply with investment policies. We have a Statement of Investment Policies, Standards and Procedures which is available on our website.

The CEA, amongst other things:

- provides for the framework for governance (including the degree to which the Guardians is required to give effect to, or be independent of, government policy);
- clarifies the powers and duties of board members in respect of the governance and operation of the Guardians, including their duty to ensure the financial integrity of the Guardians; and
- sets out the reporting and accountability requirements.

### *Key personnel*

Board members and our management structure are set out on our website. The role and duties of the Board are detailed in the Board Charter, which is also on our website along with information about Board and Management Committees.

Board member remuneration is set by the Minister of Finance in accordance with the Fees Framework for Members of Statutory and Other Bodies Appointed by the Crown <http://www.dpmc.govt.nz/cabinet/circulars/co09/COC-09-05.pdf>. Total remuneration is disclosed in each Annual Report.

## **How we invest**

We have dealt in considerable detail with how we invest (including our approach to structuring the Fund, Responsible Investment, New Zealand investment and risk management) on our website. In particular see the *What We Do* and *Structuring the Fund* sections.

## **Performance**

We disclose on our website a significant amount of information about the performance of the Fund including:

- Information about our performance (and cost) benchmarks including why we have chosen them (under the *What We Do* section)
- Monthly performance figures (under the *Performance* section)
- Monthly data on our asset allocation, 10 largest holdings in New Zealand and offshore and significant shareholdings (under the *Performance* section)
- Annual performance in our Annual Report, including an assessment of the value we have added over the year (under the *News and Reports* section)
- A list of all of our equity holdings, published annually (under the *Structuring the Fund* section).

## **Transparency**

The Guardians are subject to significant scrutiny. Regardless of who is watching, the level of transparency expected of us as a Crown entity is high. For example we are the only Sovereign Wealth Fund in the world to disclose monthly performance figures.

Additionally we have adopted an organisational approach of being as transparent as possible with respect to our investment decisions and about our organisation more generally. As a consequence we are recognised for our transparency. You can see on our website under the *Performance* section how we have been rated by various organisations in this respect.

# NEW ZEALAND SUPERANNUATION FUND

PO Box 106 607, Auckland 1143, New Zealand

Level 17, AMP Centre, 29 Customs Street West,  
Auckland, New Zealand

Office: +64 9 300 6980 | Fax: +64 9 300 6981 |

Web: [www.nzsuperfund.co.nz](http://www.nzsuperfund.co.nz)

If you are an investment manager you may have a particular interest in the below sections of the website.

To learn more about how we select and rate managers for public markets investments go to [www.nzsuperfund.co.nz/PublicManagers](http://www.nzsuperfund.co.nz/PublicManagers)

To learn more about how we think about private markets' investments go to [www.nzsuperfund.co.nz/PrivateMarkets](http://www.nzsuperfund.co.nz/PrivateMarkets)

To further understand how we select and rate managers for private markets investments go to [www.nzsuperfund.co.nz/PrivateManagers](http://www.nzsuperfund.co.nz/PrivateManagers)

To understand our approach to Responsible Investment go to [www.nzsuperfund.co.nz/ResponsibleInvestment](http://www.nzsuperfund.co.nz/ResponsibleInvestment)