12 November 2014

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By email: Robert.Ashe@parliament.govt.nz
CC: Russel.Norman@parliament.govt.nz

Dear **Robert,**

REQUEST UNDER THE OFFICIAL INFORMATION ACT 1982

Thank you for your request dated 14 October 2014 made pursuant to the Official Information Act 1982 ("**OIA**") and further clarified by you on 21 October 2014 and 5 November 2014.

Your Request

The purpose of your request is to: "understand the work the New Zealand Superannuation Fund (the Fund) has done to show leadership in the face of a growing international movement to divest from fossil fuel producers".

Summary of our response

The Fund is managed by the Guardians of New Zealand Superannuation (**"Guardians"**). The Guardians is recognised internationally for its approach to responsible investment.

Environmental, social and governance (ESG) considerations are integrated into all aspects of the Fund's investment activities, from investment selection and due diligence to ownership activities such as monitoring our external investment managers, exercising our voting rights and engaging with companies to improve their ESG policies and practices.

Our responsible investment work programme is closely aligned to the United Nations' Principles for Responsible Investment (UNPRI). In all UNPRI assessments since 2010 for which UNPRI benchmarking is available, we received a top-quartile rating across all six UNPRI principles. This indicates that we are managing responsible investment issues and risks to a best practice standard and means we are one of the best performing UNPRI signatories globally.

Our 2014 UNPRI Transparency report is available on our website at: https://www.nzsuperfund.co.nz/performance/esg-management. We expect that the UNPRI will make another benchmarking report public in 2015.

As noted in our Chair's Statement in our 2013/14 Annual Report, we are concerned about climate change and have undertaken significant work to build the risks and opportunities associated with it into our investment process. As a result, we are committed to a long-term strategy to increase the Fund's exposure to low-carbon and renewable energy.

As outlined in some detail on our website, we have a strong commitment to engagement: using our influence as a shareholder to encourage companies to manage and report on their ESG risks. As outlined in more detail below, in principle we believe that divestment is not as effective as analysis and engagement in encouraging companies to change. We consider it a last resort.

As a result of engagement programmes by the Guardians and other investors around the world, companies are increasingly aware that investors are analysing their ESG performance and expecting them to address ESG issues for the long-term value of the company.

Specific Questions

We have worked through your specific questions in order below.

1. **What analysis has the Fund done on the risks, if any, of investments in companies directly involved in the production of fossil fuels?**
   We have undertaken significant work to understand the investment risks and opportunities associated with climate change (e.g. physical impacts and regulatory activities). We also expect our external investment managers to integrate material environmental considerations, including climate change, into their investment analyses.

   During 2010, we convened a climate change project team across our investment teams to consider the investment implications of climate change more broadly for the portfolio and the New Zealand Emissions Trading Scheme (ETS) specifically. We are currently preparing documents relating to this project for release to you.

   In 2011 we conducted analysis on climate change as a theme and produced a macro-thematic strategy paper on climate change. This is also one of the documents we are currently preparing for release to you.

   In 2012, climate change was integrated into investment opportunity analysis in the energy sector, in particular in regarding to an analysis of the alternative energy sector. Our analysis also looked at the role of gas, particularly in the United States, with implications for replacing coal in electricity generation.

   During 2013-14, our work on climate change focused on our alternative energy strategy.

   During this whole period we have continued to engage on climate change issues with listed companies, particularly through our support of the Carbon Disclosure Project, International Group on Climate Change and United Nations Principles for Responsible Investment.

   Looking forward, following the release of the Fifth Assessment Report by the Intergovernmental Panel on Climate Change (IPCC) in 2014, our focus will be on the Mercer-led collaborative research project on climate change we announced we were supporting in September (see https://www.nzsuperfund.co.nz/news-media/nz-super-fund-backs-mercer-climate-change-scenario-study).

   The Mercer research project, which will be completed in 2015, will inform our future thinking on climate change risk. Collaborating with other investors is a cost-effective way for us to access research of this sort.

2. **What analysis, if any, has the Fund done on divestment from companies directly involved in the production of fossil fuels?**
   In principle we believe that divestment is not as effective as analysis (e.g. encouraging brokers and investment analysts to integrate climate risk into company valuations) and engagement (e.g. encouraging company reporting on carbon emissions and climate change risks) as a driver for companies to change. Analysis and engagement will fundamentally impact a whole-of-market view of a company rather than reallocating share-ownership to other investors through share sales (divestment). Divestment may impact on the reputation of companies and may make some companies less attractive to some investors, but could equally make the shares more attractive to other investors if they believe such divestment has led to a mispricing opportunity.

   Many companies that are exposed to 'fossil fuels', such as mining, utilities and oil companies, have substantial business activities in other non-fossil fuel businesses, including renewable and alternative energy. Additionally, one of the fossil fuels, gas, is seen as a lower-carbon bridging fuel to renewables and is also contributing to lowering emissions through coal to gas conversions - this adds complexity to the wholesale divestment of fossil fuel stocks.

   In 2010 and 2012 we commissioned third party quantitative ESG analyses on the Fund's listed equity portfolio compared to its passive benchmark. The reports included climate change as one of the ESG factors analysed and showed that the ESG performance data of our portfolio (e.g. carbon footprint) was very similar to the benchmark. The reports were constrained by the lack of data available in the marketplace although this has improved in recent years due to initiatives such as the Carbon Disclosure Project. The reports, which were not captured by your information request as set out at question 8, used proprietary methodology belonging to the third party research firms involved and are therefore confidential.

   Large divestment decisions reduce the diversification of the portfolio. It is therefore difficult to be confident that divestment will lead to market out-performance rather than market under-performance.

   In considering the issue of fossil fuel divestment, we also note that complete divestment of fossil fuel companies on the grounds of mitigating the risk of stranded assets would remove a buffer against other types of investment risk, for example in times of high oil prices.

3. **Has the Fund sought an opinion on whether the investment in companies directly involved in the production fossil fuels prejudices New Zealand's reputation as a responsible member of the world community? If so, what was that opinion? If not, why not?**
   We have not sought such an opinion.

   Any decision by the Guardians to divest is based on a clear process and principles (our Responsible Investment Framework). We place a strong weighting on products banned under international conventions or NZ law; on illegal activities; and on severe breaches of international standards.

   Further, our stance on issues such as this is informed by the policy stance of the elected New Zealand Government as the best way of interpreting the will of the New Zealand public.

   The Government has chosen to commit to international agreements such as the Kyoto Protocol and to steer the economy towards a lower carbon footprint using an Emissions Trading Scheme. It has not chosen to prohibit the use of fossil fuels nor the exploration and production of fossil fuels. Nor have other countries done so.

Under these criteria, an opinion has not been sought as it is clear that investing in coal, oil and gas does not prejudice New Zealand's reputation internationally.

4. Has the Fund considered whether engagement with companies directly involved in the production [of] fossil fuels is likely to be successful? If so, what were your findings?

We assess the likelihood of success of our engagement initiatives. Our engagement on improving disclosure has been successful. Through our membership of the Carbon Disclosure Project and the Investor Group on Climate Change, we actively encourage our investment managers, analysts, research agencies and companies to analyse, and provide pricing reports to the market, on climate change issues – looking at both risks and opportunities. These initiatives have already helped to improve the market's analysis of the risks to companies involved in fossil fuel production – including from regulatory policy, physical impacts of climate change and opportunities to shift to lower carbon strategies.

Carbon Disclosure Project reporting by companies in the oil & gas sector has improved from 15% to 70% since 2004, and overall the Carbon Disclosure Project has increased the number of companies reporting on climate change data and strategies from 221 in 2003 to 4500 in 2013.

Our engagement with companies involved in hydraulic fracturing focuses on ESG best practice including capturing fugitive methane emissions. We believe that where good practice industry guidelines are available we can have a positive impact, through engagement, in encouraging their implementation.
http://www.unpri.org/press/pri-signatories-target-fracking-disclosure

Whilst investor engagement plays a role in influencing these companies to improve their environmental reporting and performance on climate change, regulatory and commercial drivers play the most vital role as key drivers for change in this sector.

We try to engage in collaboration with other investors, including some very large international investors. By engaging collectively, our capital carries a great deal more weight.

5. What engagement, if any, has the Fund taken with companies directly involved in the production [of] fossil fuels?

As mentioned above, we have been actively involved for a number of years in engaging for improved disclosure on climate change risk management and carbon reporting across many sectors, including those involved in fossil fuel production.

The Guardians is participating in a UNPRI-led engagement project that focuses on global energy companies involved in hydraulic fracturing, including exploration and production, and oilfield service companies, operating in a number of markets including North America, Europe and China. The engagement aims to encourage companies to adopt good practice and report on their management of the risks associated with hydraulic fracturing. http://www.unpri.org/press/pri-signatories-target-fracking-disclosure/.

During 2013/14, the Guardians also engaged collaboratively with two energy infrastructure companies, succeeding in getting the companies concerned to improve their transparency about community and climate change risks with stakeholders.

We continue to work with our external investment manager KKR, with whom we have an energy-focused investment mandate, to use our influence to encourage good-practice management of hydraulic fracking operations. For further details of this investment, please refer to the publicly available information on our website at https://www.nzsuperfund.co.nz/news-media/nz-super-fund-invest-us250-million-kkrs-energy-practice and pages 56 & 66 in our 2014 Annual Report.

6. **To what degree does the issue of climate change influence the Fund's investment decisions?**
Given the Fund's long-term investment horizon (it will not peak in size until the 2080s), it is important it is future-proofed against wider economic, social and environmental trends such as climate change. Climate change has therefore been factored into the development of our energy sector strategy and continues to be a focus of our macro-economic and investment analysis work, as evidenced by our participation in the Mercer collaborative project.

   ESG issues are integrated into our risk allocation (portfolio construction) process. For each broad investment opportunity set, the degree to which ESG risks can be mitigated or the degree to which there are beneficial ESG impacts, is assessed and scored. This has a direct impact on ranking the attractiveness of investment opportunities (and existing investments). Where climate change is a significant risk or the investment could provide a significant beneficial impact for addressing climate change, then this influences the ranking of that investment. Further information about the risk allocation process is available on our website at: https://www.nzsuperfund.co.nz/how-we-invest-actual-portfolio/risk-allocation

   The risk allocation process ranks the attractiveness of potential investment opportunities at a high level. When an actual investment proposal is identified and enters due diligence, then a more granular assessment is undertaken. If climate change is a key ESG issue for that investment then it will be included in the due diligence process including an operational risk assessment considered by the Risk Committee and Investment Committee.

   We also integrate ESG requirements into our mandates with external managers. This includes specific requirements related to climate change in mandates and ongoing work with our rural, forestry and property managers.

7. **How specifically have Fund investments changed over the years to account for climate change?**
Since 2012, where a strong investment case can be established, we have actively sought to further incorporate active investments in alternative energy, and energy forms with lower carbon intensity, into the Fund. We expect that, if we are successful in implementing this strategy, our portfolio will become more heavily invested in renewable energy and less carbon-intensive over the long term. Examples of investments that complement this strategy include our recent direct investments in Bloom Energy and Ogin.

8. **Can you please release all emails and advice, if any, from the Fund specifically referencing the Government's position on climate change since January 1, 2009.**
On 5 November 2014, you clarified the above request, specifying that in interpreting what you mean by the Government's position on climate change, references to the NZ Government's Emissions Trading Scheme **should** be included. You agreed with our proposal that duplicate documents need **not** be provided and specified that drafts **should** be included.

   We have identified some documents that are captured by your request and are currently preparing these for release. These documents, which we believe are the substantive documents relating to your request, will be sent to you shortly.

   We have also re-worked our document search following your clarification regarding the Emissions Trading Scheme and confirmation that you require drafts of documents. Our search indicates there are more than 2,000 individual documents mentioning the Emissions Trading Scheme.

We invite you to refine your request in order to reduce the time needed to compile the documents you are looking for. In the meantime, your request is refused pursuant to section 18(f) of the Official Information Act 1982 on the basis that the information requested cannot be obtained without substantial collation or research, and would divert Guardians' resources away from other important work to a degree that would impact negatively on our ability to perform our duties.

With regard to references to the Emissions Trading Scheme, please note that details pertaining to this are published each year in the Financial Statements for the Fund in our Annual Report. For example, with regard to our 2013/14 Annual Report., see the references to carbon credits on pages 112 and 133; and contingent liabilities on page 137.

9. **What is the Super Fund's position on the idea of "stranded assets"?**
   Mispricing, which is the basis for the "stranded assets" debate, is a key consideration for our investment team. The Mercer research project will specifically assess stranded asset risk under different scenarios. Our macro-thematic work on climate change has considered the issue of carbon pricing and policy impacts. In addition, enhanced disclosure of climate change risk exposure by companies will better enable investment markets to price climate change related risks, such as that of 'stranded asset' risk, into asset prices.

10. **Does the Fund agree with the International Energy Agency that two thirds of known fossil fuels must stay in the ground if the world is to avoid dangerous climate change?**
   We have not independently verified the International Energy Agency's analysis, but we do respect and utilise its research. The International Energy Agency reports were a fundamental source of analysis for our energy strategy, including its assessment on fossil fuel resources, future energy mixes and implications of climate policy that meets commitments to limit global warming to two degrees.

11. **The most up-to-date figure of the Fund's total investment in companies directly involved in the production of fossil fuels and what this represents as a percentage of total investments.**
   On 17 October we proposed basing the calculation needed to respond to this question, for listed equities and bonds, on the Global Industry Classification Standard (GICS) codes. GICS codes are an industry taxonomy developed by MSCI and Standard & Poor's for use by the global financial community. GICS is used as a basis for S&P and MSCI financial market indexes in which each company is assigned to a sub-industry, and to a corresponding industry, industry group and sector, according to the definition of its **principal** business activity.

   On 21 October you agreed with our proposal that we include investments with the following GICS codes:
   - Coal & Consumable Fuels
   - Integrated Oil & Gas
   - Oil & Gas Drilling
   - Oil & Gas Exploration & Production.

   You agreed that investments with the following GICS codes should not be included:
   - Oil & Gas Equipment & Services
   - Oil & Gas Refining & Marketing
   - Oil & Gas Storage and Transportation.

You also agreed that we should include any relevant companies within private equity funds or other external investment mandates in the total, as best possible.

As at 30 June 2014 (last audit date) we estimate that the Fund had NZ$676 million invested in companies directly involved in the production of fossil fuels. This total comprises approximately 2% of the Fund's assets under management as at 30 June 2014 (pre-tax).

The total includes 244 unique securities (listed equity holdings and bonds) as per the GICs codes listed above (see Appendix A for a list of the securities), and investments in five unlisted external investment mandates, predominantly the KKR energy mandate we announced in 2014. As noted above, for further information on this mandate see: https://www.nzsuperfund.co.nz/news-media/nz-super-fund-invest-us250-million-kkrs-energy-practice and pages 56 and 66 in our 2014 Annual Report.

Should you wish to compare our equity holdings with the "Carbon Underground 200" that you mentioned to us, please refer to the publicly available list of our 2014 listed equity holdings at https://www.nzsuperfund.co.nz/publications/annual-equity-listings. The Carbon Underground 200 is based on carbon emissions data. There are therefore some companies in the Carbon Underground 200 that we hold in our portfolio, but which are not captured by the GICs codes agreed above (an example would be Maersk Group).

Please note that the Fund will also have indirect exposure to companies involved in the production of fossil fuels through derivative products such as futures and total return swaps. Please note that the Fund may also have some limited indirect exposure through investments in pooled funds.

General

As you may know, you have the right to seek a review by the Ombudsmen's Office of decisions to withhold information requested under the Official Information Act. We set out the details of the Ombudsmen's Office below should you wish to contact the office regarding our response to your request.

The Ombudsmen's details are: at: http://www.ombudsmen.parliament.nz/.

Free phone:	Email:	Fax:
0800 802 602 (+64 4 4739533)	info@ombudsmen.parliament.nz	(04) 471 2254

Yours sincerely
Adrian Orr
Chief Executive Officer