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19 February 2021

Grant Robertson
Minister of Finance
Parliament Buildings
Wellington
(By email)

RE: Response to annual letter of expectations

Dear Minister,

I am writing in response to your letter of 22 December 2020 setting out the Government's annual expectations for the Guardians of NZ Superannuation. I wish to place on record the Board's thanks for the support shown by you and your officials as we managed through the impact of Covid-19, and note your desire to build on the good work achieved over the past year.

This letter covers our response to your letter of expectations and sets out how the Guardians can support New Zealand's recovery from the impacts of the pandemic, and play our part in the country's economic, social and environmental progress.

NZ Super Fund value to New Zealand

We note the expressed priorities of the Government, especially in relation to the response to Covid-19, and appreciated the opportunity to discuss these with you at our recent Board strategy day.

As you are aware, the NZ Super Fund was established to help smooth future cost increases of providing universal superannuation entitlements. By doing this the NZ Super Fund adds to Crown wealth, improves the ability of future Governments to pay for superannuation, and ultimately reduces the tax burden on future New Zealanders.

The Guardians' most fundamental contribution to the wellbeing of New Zealanders therefore comes from fulfilling our legislative requirement to successfully invest the NZ Super Fund.

Since inception the Fund has received net contributions from Government (after payment of tax) of \$11.4 billion. This compares with the net asset value of the Fund of \$55.4 billion as at the time of writing i.e. the Fund's capital has multiplied by almost five times since 2003, during which time it has significantly exceeded its performance benchmarks.

Under current modelling, the Government will begin to withdraw money from the Fund in 2035/36, with significant disbursements to begin in the mid-2050s. Capital withdrawals from

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the Fund will meet 10% of the net cost of Super by 2066, peaking at 12.8% in 2078, and averaging 11.2% for the 50 years from 2060-2110. The Fund will also be paying tax to the New Zealand government in addition to the capital withdrawals.

At the Fund's peak in the 2070s, the capital withdrawals and tax payments combined total 21% of the total net cost of pensions, and more than 40% of the incremental cost increase due to the rising proportion of retirees in the population.

Contributing to New Zealand's economic, social and environmental progress through investment industry leadership

The Fund is now one of the largest institutional investors in New Zealand and plays a significant role in New Zealand's capital markets. Overall, the Fund has just over NZD7.2 billion invested in New Zealand, or 18.4% of its total investments by value.¹

We aim to play an active role in strengthening New Zealand's capital markets and institutional investment capability, as evidenced by our involvement in a range of industry fora and initiatives in recent years, including:

- New Zealand Corporate Governance Forum (which we established);
- Sustainable Finance Forum;
- Capital Markets 2029;
- Te Pūia Tāpapa Investment Fund;
- Providing responsible investment services to the other crown financial institutions;
- University of Otago Investment Chairs Seminar Series; and
- Responsible Investment Association of Australasia.

Infrastructure Investment

We are interested in pursuing large scale domestic infrastructure investment where suitable commercial opportunities can be found, and would welcome the opportunity to discuss this further with Government Ministers and officials.

Our preferred investment model for large-scale infrastructure is an equity-funded end-to-end delivery solution (i.e. planning, financing, building and operating), which has benefits including increased financial flexibility, faster delivery and greater risk tolerance. It is based on long-term investments in large-scale infrastructure by publicly owned and commercially focused investors, in partnership with central and local governments. The model shares some attributes with structures such as the 'Alliance' model that has been used occasionally to fund infrastructure in New Zealand, but is fundamentally different to the more common Public-Private Partnership (PPP) funding model.

To progress our infrastructure ambitions, the Guardians has appointed new in-house infrastructure investment capabilities to help us identify and transact suitable opportunities. We have also engaged with the Infrastructure Commission on production of its strategy

¹ Calculation based on the value of the NZ Super Fund's New Zealand investments, as a proportion of the value of the NZ Super Fund's investments figure in our financial statements. This calculation includes investments in rural and forest land, but excludes foreign exchange hedging instruments such as FX contracts and cross currency swaps.

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document, providing an investor perspective to the planning and delivery of its proposed pipeline of projects.

Risk tolerance

The Fund's long-term horizon means it can adopt a relatively high risk/return profile, made up of 80% growth assets (equities) and 20% fixed income (bonds and other instruments). Our recent 5-yearly review of the Reference Portfolio considered and ultimately maintained the 80/20 risk profile as being appropriate for the Fund's purpose and mandate.

We are confident that our risk management processes, both in terms of investment risk and enterprise risk, are in line with global best practice investment management.

CFI information strategy project

Guardians staff are actively involved with Treasury and the other Crown Financial Institutions on this workstream. We will continue to work constructively with officials to assist their understanding of the Guardians' investment approach and risk exposures, and ensure information can be provided in an efficient and cost-effective way.

Use of Derivatives

We note your expectations regarding the use of derivatives. Derivative instruments have a vital role to play in investing the Fund, both as a way of investing cost-effectively and in managing risk. We remain comfortable that management has the requisite skills and is applying appropriate control, policies and procedures to these instruments, the use of which is considered standard industry practice globally.

Partnership

We note your expectations regarding partnerships within the public sector and in particular the sharing of expertise between with the Crown Financial Institutions.

We work closely with the Crown Financial Institutions, in particular on responsible investment matters, and liaise regularly with other Government entities on issues relating to operations, expenses and communications, including Treasury, MBIE, Ministry of Foreign Affairs and Trade, Reserve Bank, Department of Prime Minister and Cabinet, Green Investment Fund and others.

Citizenship

We look forward to ongoing engagement with your officials in respect of the Government's proposed ethical investment framework. We also recognise the transparency, urgency and consistency you expect the Crown Financial Institutions to show in responding to climate change. The Guardians is a global investment leader in this area, and published our first report in line with the Task Force on Climate-related Financial Disclosures last year. We are happy to contribute our expertise and insights.

We also note your suggestion that the Crown Financial Institutions maintain robust responsible investment frameworks. One of the Guardians' key strategic initiatives for 2020/21 is a project to review and refresh our now 13-year-old Responsible Investment strategy and ensure it is fit for the future. Approaches to RI and ESG (Environment, Social and Governance) are evolving, with new tools and methodologies. Stakeholder expectations and the external context have also evolved, including a global focus on sustainable finance. The project will look at ESG performance across the portfolio, positive investment (in line

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with our mandate) and external trends and stakeholder expectations. We anticipate that our work in this area will make a useful contribution to the Government's ethical investment framework.

We note your request that we consider where our investment mandate can support the Government's goals, within the bounds of our commercial mandate and overarching purpose. Furthermore, as a high profile investor with long-term capital deployed in New Zealand and a commitment to responsible investment leadership, we absolutely recognise the importance of earning and maintaining a reputation as a 'good citizen' in the New Zealand market. These matters will be considered within the refresh of our responsible investment strategy outlined above.

Expectations Specific to the Guardians

Responsible Investing

As noted above, we will continue to share our expertise on climate change investment strategy with the other Crown Financial Institutions. We will also share with them what we learn about global best practice and trends in the course of the refresh of our responsible investment strategy.

Venture Capital Fund

We note your expectation that the Guardians should continue to apply best practice investment management to our oversight of the Elevate NZ Venture Capital Fund. At the time of writing Elevate had made three investments via NZ Growth Capital Partners:

- Blackbird Ventures' New Zealand fund - \$21.5m (8 Sept)
- Movac 5 - \$10m (23 Sept)
- Pacific Channel - \$20m (12 Oct)

A fourth investment in Finistere (up to \$15m) is expected to be finalised shortly. It is likely that investment activity will slow down substantially in 2021 and 2022. We will continue to be proactive in communicating any significant developments to the Government.

Policy discussions

We note your willingness to discuss the optimal policy settings to assist us in achieving our mandate. Several of our suggestions were included in our Briefing to the Incoming Minister covering: infrastructure investment, taxation of the Fund and section 59. We will continue to work with you and officials on these and other matters, and acknowledge the request that these issues are communicated through official channels.

I look forward to progressing these and other initiatives as Chair of the Guardians until my term ends on 31 March.

Yours sincerely,



Catherine Savage
Chairperson of the Guardians of NZ Superannuation