Guardians of New Zealand Superannuation
Briefing to the Incoming Minister of Finance

December 2020

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

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Briefing to the Incoming Minister of Finance

Guardians of New Zealand Superannuation

and

New Zealand Superannuation Fund

and

Elevate NZ Venture Fund

19 November 2020

For further information:

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Contents

1 Overview

Background

The New Zealand Superannuation Fund ("NZ Super Fund", "the Fund") is a portfolio of financial assets owned by the Crown. It was established to help pay for the increased cost of universal superannuation entitlements in the future. 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 of the cost of superannuation on future New Zealanders. The NZ Super Fund is managed by a Crown entity, the Guardians of New Zealand Superannuation ("Guardians").

Under the New Zealand Superannuation and Retirement Income Act 2001, the Guardians must invest the NZ Super Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with:

- best-practice portfolio management;
- maximising return without undue risk to the Fund as a whole, and;
- avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

Through legislative design, the Guardians has operational independence from the Government. This model is recognised internationally as best practice and is fundamental to the Guardians' reputation globally for excellence as a sovereign investor.

Strategic Priorities

The Guardians' strategic priorities are:

- 'best portfolio' – ensuring we have the most cost-effective and fit-for-purpose investment portfolio;
- 'strong external relationships' – globally and in New Zealand;
- 'building and maintaining a great team' – strong focus on workplace culture; and
- 'efficiency, scalability and innovation' – building agile and scalable systems.

Strategic Activities 2020/21

The Guardians' current strategic activities are:

- refreshing our Responsible Investment strategy;
- searching for and selecting a suite of digital solutions to transform HR processes and data to deliver efficiencies and increase the value of the workplace experience;
- develop a data strategy to articulate our data aspirations and capability requirements
- undertaking several initiatives to sustain the Guardians' culture, and;
- implementing control effectiveness assessments and key risk indicators for the Guardians' top risks.

2 Performance

Since 2003, Government has contributed $19 billion to the NZ Super Fund which, as at 31 October 2020, was worth $47 billion. Since inception the Guardians has, on a before NZ tax/after costs basis:

- added an estimated $28 billion to the NZ Super Fund, compared to the Treasury Bill return, and;
- added an estimated $8 billion in value to the NZ Super Fund, compared to a market "Reference Portfolio" return.

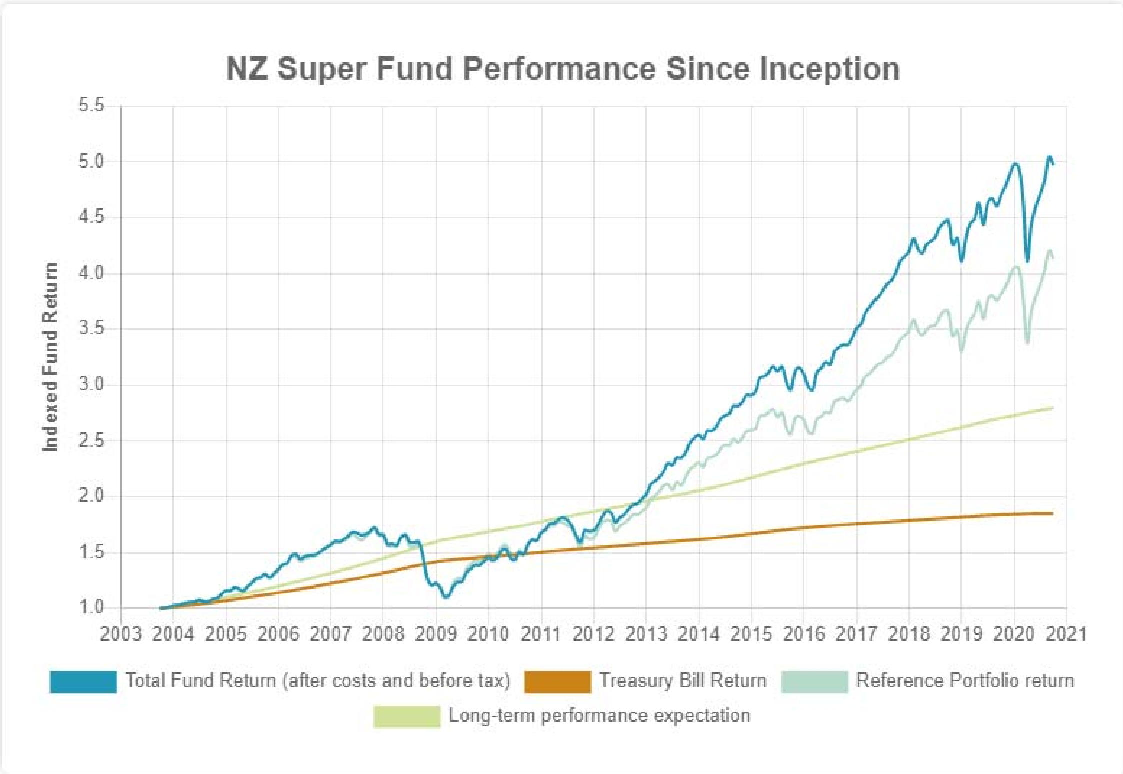
All returns are reported after costs and before New Zealand tax.

Performance as at 31 October 2020	Last 12 months	Last 5 years p.a.	Last 10 years p.a.	Since inception p.a.
Actual Returns	2.52%	9.41%	11.73%	9.69%
Reference Portfolio Return	4.89%	8.49%	9.62%	8.51%
Value added over Reference Portfolio Return	-2.37%	0.92%	2.11%	1.18%
Treasury Bill Return	0.58%	1.55%	2.15%	3.65%
Value added over Treasury Bill Return	1.94%	7.86%	9.58%	6.04%

The NZ Super Fund has paid $7 billion to the Crown in tax since investing began (we include New Zealand tax paid in measurements of the NZ Super Fund's performance because we consider it to be a return to the Crown).

The Guardians has successfully invested the Government's contributions in New Zealand and overseas, returning 9.69% per annum, after costs and before NZ tax, since inception. This rate of return has significantly exceeded both market returns over the same period, and the return on Government debt (Treasury Bills).

Further information on Fund investment performance is available at: https://www.nzsuperfund.co.nz/performance/investment



Treasury Bill return benchmark

The Guardians' expectation, given our mandate and hence portfolio construction, is that the NZ Super Fund will return at least the Treasury Bill rate + 2.8% p.a. over any 20-year moving average period.

The Treasury Bill rate + 2.8% is not a target to be hit precisely - rather, it is a long-term performance expectation that the Guardians aims to beat by as much as possible. Working to an expectation rather than a target avoids any short-term incentive to simply add risk to the NZ Super Fund if expected returns are low, and vice versa.

Our research shows that over any 20 year period going back to 1929, with the portfolio construction the Fund has, it would beat the government risk free rate of return, and more than 90% of the time the Fund would beat it by 2.5% per annum more.

Comparing the Fund's returns with the Treasury Bill benchmark is a way of evaluating whether, for the Government, borrowing to invest in the Fund can be seen as worthwhile:

- NZ Super Fund return since inception = 9.69% p.a. (as at 31 October 2020)
- Treasury bills since inception = 3.65% p.a.
- Net return to Crown = 6.04% p.a. (in other words, the Crown is $28 billion better off because it invested in the Fund).

Reference Portfolio benchmark

We also compare the performance of the NZ Super Fund to a passive, low-cost Reference Portfolio, which represents a "market" return.

The Reference Portfolio is a way to:

- establish the risk level of the Fund;
- estimate the NZ Super Fund's expected returns;
- benchmark active (value-add) investment returns and costs, and;
- be clear on the 'hurdles' for active investments.

The Reference Portfolio is a shadow or notional portfolio of passive, low-cost, listed investments in keeping with the NZ Super Fund's long-term investment horizon and risk profile. As such, it is capable of meeting the NZ Super Fund's objectives over time. It has an 80:20 split between growth and fixed income investments and its foreign currency exposures are 100% hedged to the New Zealand dollar.

Approximately 57% of the NZ Super Fund is invested in line with the Reference Portfolio. Investments are only made outside the Reference Portfolio (known as "active" investments) where we have a strong level of confidence that doing so will deliver superior long-term risk-adjusted returns, and/or offer diversification benefits, albeit with more complexity and cost.

The Fund's portfolio composition can therefore be thought of as:

Actual portfolio = reference portfolio + active investments

Risk-Adjusted Returns

Focusing solely on returns ignores how smooth the ride was in generating those returns (i.e. how much risk was taking in generating them). A commonly used risk-adjusted performance metric, the Sharpe ratio, compares the portfolio returns above cash returns as a ratio to the volatility of returns. The higher the ratio, the greater the return for the risk, and vice-versa.

The Sharpe ratio enables us to compare the risk-adjusted performance of our benchmark, the Reference Portfolio, with that of our Actual Portfolio and against our expectations. This is shown below.

	Since introduction of Reference Portfolio (July 2010) to 30 June 2020	Dec 2003 to 30 June 2020
Reference Portfolio Sharpe ratio[1] (expected)	0.20	0.20
Reference Portfolio Sharpe ratio (realised)	1.18	0.49
Actual Portfolio Sharpe ratio (expected)	0.26	0.26
Actual Portfolio Sharpe ratio (realised)	1.21	0.53

[1] The Sharpe ratio is the portfolio return in excess of the T-Bill return (excess return) divided by the volatility of the excess return.

The Actual Portfolio's realised Sharpe ratio of 0.53 since inception is better than we expected and also better than that realised by the Reference Portfolio. This has been driven by higher than expected returns and lower than expected risk over the period. Given that the Fund operated under a Strategic Asset Allocation framework between 2003 and 2009, with more limited active investments, we provide Sharpe ratio figures for both the period since then and for the Fund since inception.

The Actual Portfolio's realised Sharpe ratio since 2010, when the Reference Portfolio approach was adopted, has been 1.21, greater than the Reference Portfolio Sharpe ratio and greatly exceeding our expectations. Again, this has been driven largely by returns exceeding expectations and, to a lesser extent, lower than expected risk.

Costs

Cost control is central to achieving our mission to maximise returns without undue risk. We aim to achieve the right balance between minimising cost and implementing investment strategies that will, after adjusting for risk, add the most value to the Fund over the long term.

We participate in the most widely used and comprehensive financial benchmarking available globally - the annual cost structure benchmarking survey by CEM Benchmarking. CEM assess the cost structure and value add of the Fund against 296 funds from around the world, focusing on a peer group of 19 funds of a similar size.

We aim to achieve a rating of 'median cost, median value-adding' or better in the CEM survey. This rating provides an independent benchmark of whether we have struck a good balance between minimising costs and successfully implementing value-adding investment strategies. Succeeding in this will result in better long-term investment returns for the Fund.

Latest results

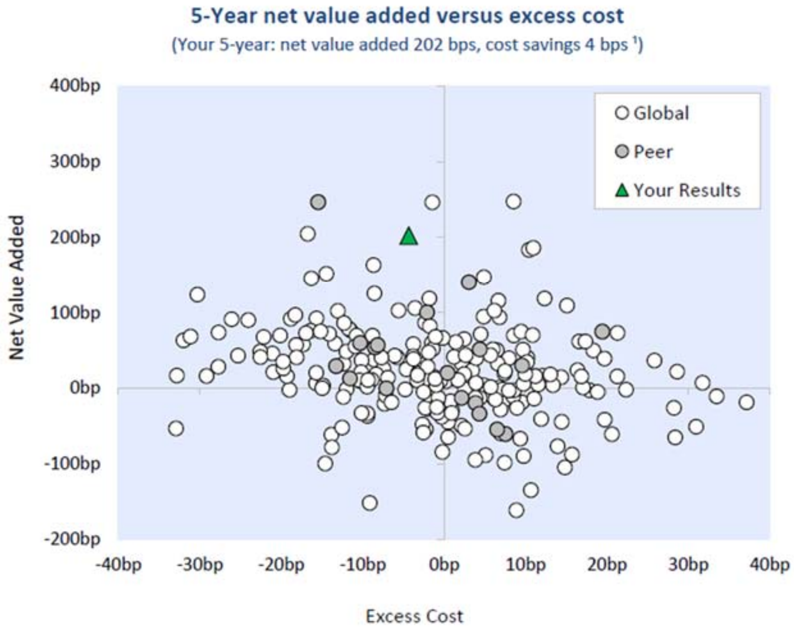
The CEM survey report is available at: https://www.nzsuperfund.nz/performance/cost/.

CEM's most recent report, for the five years ended 31 December 2019, found that the Fund's net five-year value-add was better than both the median value-add for all funds in the survey, and the median value-add of group of 19 peer funds.

This means the Fund is approximately $4 billion better off, over the five year period, as a result of this strong performance. Costs for this period were below the peer median and had decreased between 2015 and 2019. The Fund's asset risk of 13.3% was above the Global median of 9.1%. The chart which follows is from the report:

The Guardians have achieved the cost and value add desired outcomes for each of the past five years. This chart is from the latest CEM report:

Your 5-year performance placed in the positive value added, low cost quadrant of the cost effectiveness chart.



1. Your 5-year cost savings of 4 basis points is the average of your cost savings for the past 5 years.

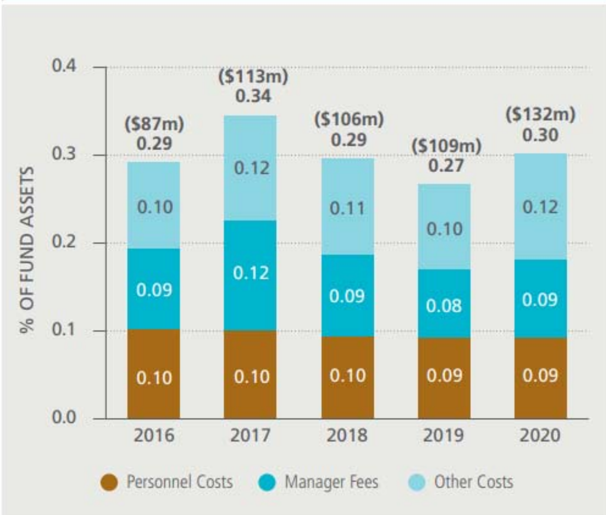
	2019	2018	2017	2016	2015	5-year
Net value added	(161.0) bp	311.0bp	209.0bp	316.0bp	280.0bp	202.3bp
Excess Cost	(8.4) bp	(2.0) bp	(1.4) bp	(3.8) bp	(6.2) bp	(4.4) bp

The chart to the right shows Fund expenditure as a percentage of funds under management over the past 5 years:

As a percentage of net asset value, the annual cost of running the Fund has been relatively stable during recent times.

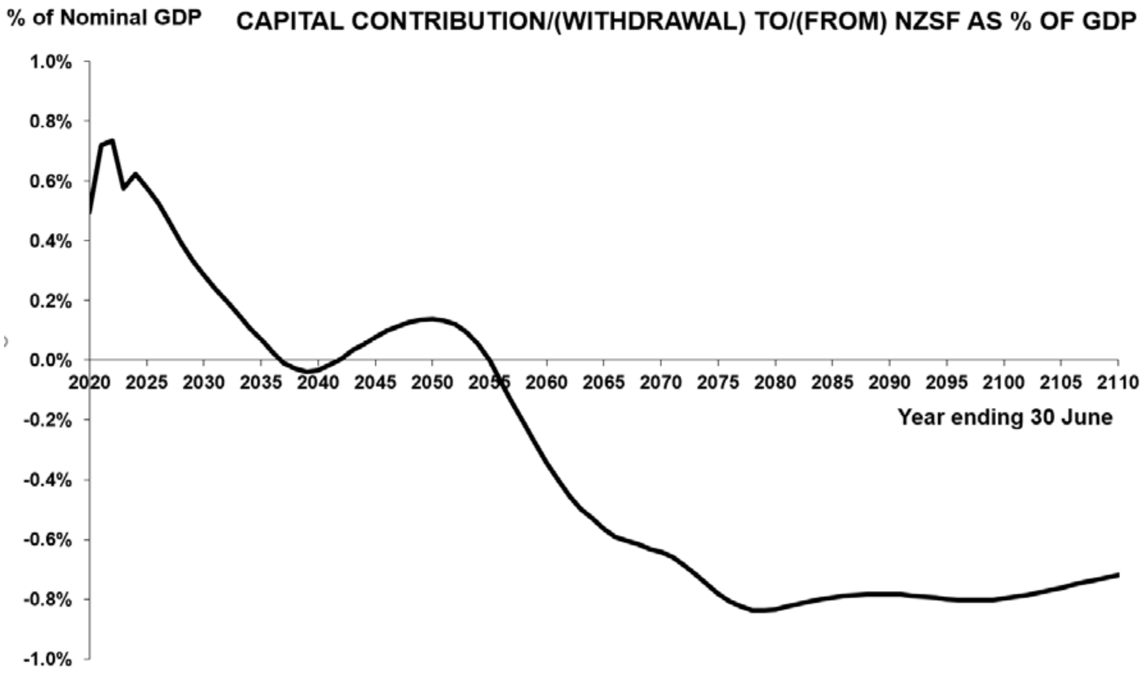
Guardians and Fund expenses are met by the Fund and paid for out of the Fund, with the exception of a small annual appropriation from Parliament to meet Board expenses and for audit fees.

Cost of Managing the Fund as a % of Net Assets

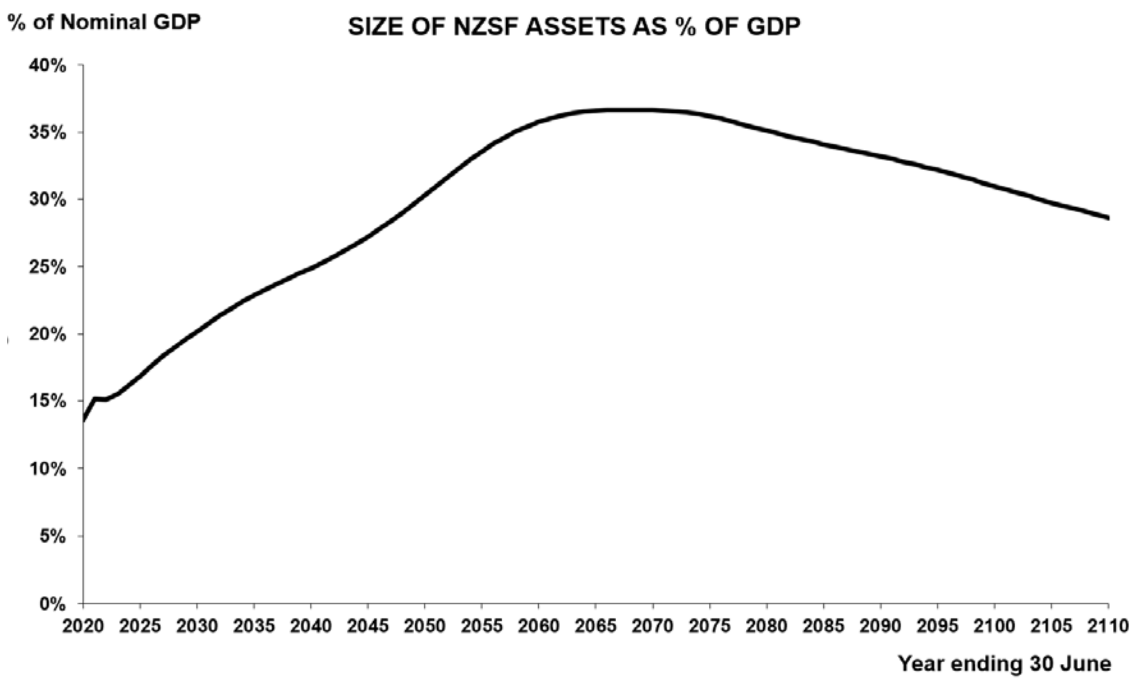


3 Purpose

Under current modelling, the Government will begin to withdraw money from the Fund in 2035/36, with full disbursements to begin in the mid-2050s. The following graph shows the shift between contributions from the government to the Fund, and disbursements (excluding tax) from the Fund back to government to pay for superannuation:

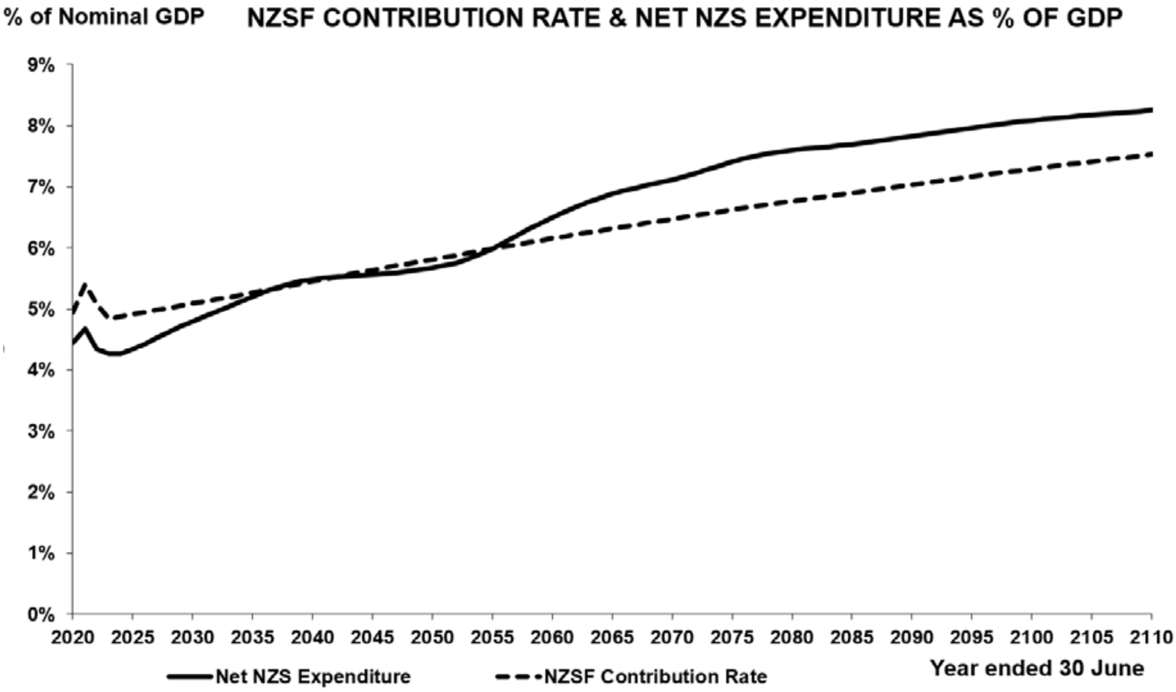


The Fund will continue to grow until it peaks in size as a percentage of GDP in the 2070s. After that time it will continue to grow in nominal terms, but will reduce in size relative to New Zealand's GDP:



Based on current Treasury projections, capital withdrawals from 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. This graph shows how the Fund's distributions help smooth out the increasing cost of providing superannuation into the future:



The actual dates when withdrawals happen are governed by the legislated formula in sections 43-47 of the NZS Act. In keeping with its long investment horizon, the Guardians has deliberately weighted the Fund towards growth assets (80% growth, 20% fixed income). In the short term, growth assets can be volatile, moving up and down in price. Because of its long investment horizon and certain cash flow, the NZ Super Fund has the ability to ride out these short term movements and benefit from the equity risk premium.

As well as reducing uncertainty over the future affordability of New Zealand Superannuation and generating wealth for the Crown, the NZ Super Fund brings a range of other benefits. As one of New Zealand's few large and genuinely long-term investment funds, it is able to:

- invest in long-dated, illiquid and productive assets including infrastructure;
- add liquidity to local debt and equity markets;
- use its influence to promote best practice corporate governance;
- offer significant economies of scale in funds management;
- access international investment expertise through collaboration and co-investment, and;
- bring financial diversification to the Government's balance sheet. New Zealand tax revenue is wholly exposed to macroeconomic conditions in New Zealand. By investing

globally, the NZ Super Fund makes future Government revenue and the ability to pay for New Zealand Superannuation less dependent on the New Zealand economy.

4 Governance and Independence

Independence and accountability

Key features of the policy design for the NZ Super Fund were that the Fund be managed by an independent governing body with explicit commercial investment objectives. As an operationally autonomous Crown entity, the Guardians is legally separate from the Crown. While it is accountable to the Government, it is overseen by an independent Board and is operationally independent.

The Act provides for a five-yearly independent review of the Guardians performance against specified criteria. The external reviewer is appointed by Treasury on behalf of the Minister of Finance. This accountability mechanism is an important feature of the statutory framework. In our most recent (2019) review Willis Towers Watson rated us AAA (exceptional) and "AA" (excellent) for our people and investment models respectively. In its report Willis Towers Watson [*link to website]* concluded:

> The Guardians has developed into an organisation that we consider to be best-practice in its activities and more than capable of achieving high performance than the vast majority of its peers.

Board members are appointed by the Governor General on the recommendation of the Minister of Finance. The Minister's recommendation follows nominations from an independent nominating committee and consultation with representatives of other political parties in Parliament. Essentially, this means that the Guardians operates at 'double-arm's-length'.

At any given time the Guardians' Board must consist of five to seven members. Members are required to have substantial experience in the management of financial investments.

Direction

NZ Super Fund investments are made on a prudent, commercial basis in accordance with the statutory investment mandate. The Minister of Finance can give directions to the Guardians regarding the Government's expectations as to the Fund's performance, including the Government's expectations as to risk and return (which the Guardians must have regard to but are not binding).

The Minister cannot give a direction that is inconsistent with the Guardians' duty to invest the Fund on a prudent, commercial basis, and cannot direct the Guardians in regard to the Fund on any other matter. This investment independence gives the Guardians confidence to enter into investment arrangements that best suit the NZ Super Fund's long-term purpose.

In 2009 we received a Direction from the Minister of Finance, requiring us to, while always investing in prudent and commercial manner, identify and consider opportunities to increase the allocation to New Zealand assets in the Fund. We report in our Annual Reports on our progress in identifying and considering domestic investment opportunities. See Section 5 of this briefing for more information on our approach to New Zealand investment.

Parameters of Mandate

The Fund cannot hold a controlling interest in an operating company. This means that the Guardians must co-invest with other investors in some circumstances. This constraint limits potential investment opportunities, particularly in markets like New Zealand where investments tend to be smaller scale, and we believe it to be unnecessary (refer to Section 5, below, for more detail).

There are some statutory constraints on borrowing, granting security interests over Fund property and holding financial instruments that place a liability on the Fund. When the Fund was established, it was considered sensible for the Crown as a whole to undertake borrowing rather than allowing the Fund to borrow. However, there are various types of transaction that fall within the bounds of the borrowing constraints but which are sensible for the Guardians to undertake as part of a prudent commercial investment strategy. The NZS Act allows the Minister of Finance to consent to such transactions. We have obtained Ministerial approval for certain transactions that technically constitute borrowing (for example, obtaining normal credit terms).

It has also been our practice to request consent for the Fund to use financial instruments such as derivatives as part of prudent commercial investment strategies (such as obtaining exposure to equity securities through derivatives rather than physically buying the equities, or using derivatives to hedge risks). This allows the Guardians to complete the Fund's portfolio in the most efficient, effective manner possible and also allows for the execution of active strategies that could not be undertaken without the use of derivatives. We report on the use of derivatives in our Quarterly Ministerial Reports.

CEO remuneration

CEO remuneration is set by the Guardians' Board, based on external market data. While the terms and conditions of employment of the CEO are determined by agreement between the Board and the CEO, the Board must obtain the written consent of the Public Services Commissioner before finalising or amending the CEO's terms of employment. The Public Services Commissioner must provide reasons for refusing consent to any proposed terms and conditions and is required by the Act to have regard to the following (among any other relevant factors):

- the legal, commercial and operational context of the relevant Crown entity;
- any information provided by the Board, which might include, for example, the Board's advice about a person's knowledge, skills, experience and performance;
- the public interest in prudent stewardship of public resources;
- Government expectations, and;
- relevant market information.

As a result of the findings of the independent statutory review of the Guardians that changes to the Crown Entities Act creates difficulties for the Guardians' remuneration structures, the Public Services Commissioner advised us that he intended to discharge his obligations under

Section 117 of the Crown Entities Act by treating the Guardians as if it were a State Owned Enterprise (SOE). He advised that he will do this by providing remuneration guidance to the Board that is consistent with the advice that Treasury provides to SOEs, and will consent if the Guardians agrees to implement that guidance.

Board fees and expenses are paid from Parliamentary appropriation. Staff salaries are funded out of the Fund and not by Parliamentary appropriation. Salaries reflect the need to recruit highly skilled personnel who can deliver value in terms of Fund performance, relative to cost incurred. All at-risk performance incentives are paid at the Board's discretion.

5 Current issues and recommendations

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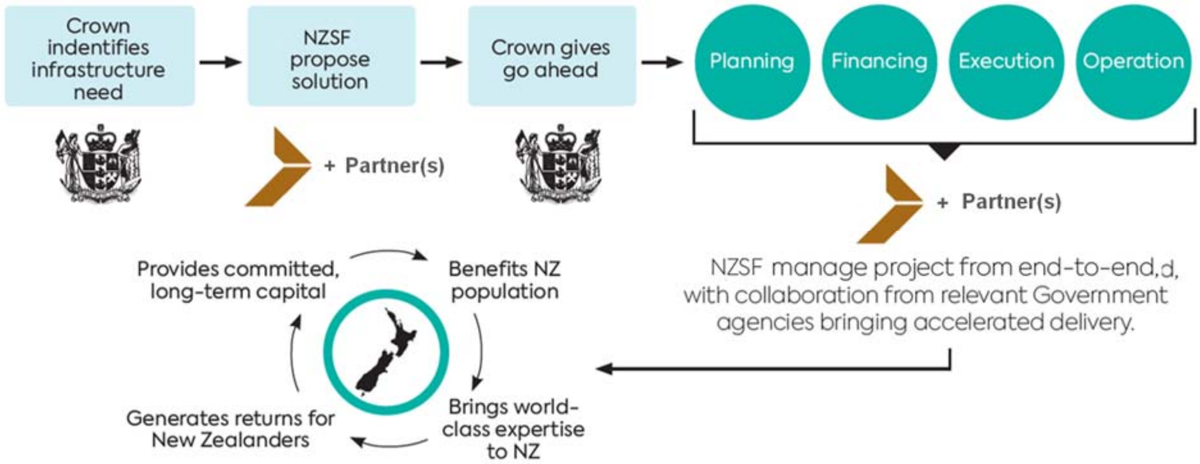
[33]

Infrastructure investment

Our interest in infrastructure investment began seriously in 2017 when we looked into international models for infrastructure delivery that would allow the Guardians to invest our domestic New Zealand public capital into local (and international) infrastructure opportunities. The result is the Public-Public Investment (PPI) model:



We believe infrastructure investors' time horizons should be aligned with the infrastructure's expected life to design and create an investment that will stand the test of time, which is why the PPI NZ model 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.

Please note that the discussion on the impact of the current control restriction in s59 is also of particular relevance to the model.

Rational for infrastructure investment

Infrastructure is an attractive investment category for the NZ Super Fund because of its consistent, competitive returns and yields, defensive characteristics and diversification benefits. It also has the potential to deliver the scale we require of our active investments in order to be meaningful within what is a NZD47 billion and growing portfolio. In addition, infrastructure is a scalable way in which the Guardians can deliver on the direction we received from the Minister of Finance in 2009, to consider opportunities to increase the allocation of New Zealand assets in the NZ Super Fund, in a manner consistent with our investment mandate and objectives.

The infrastructure investment model is based on long-term investment in large-scale infrastructure by publicly-owned but commercially-run investors, in partnership with central and local governments. It shares some attributes with models 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.

Late in 2017, we considered a range of potential infrastructure projects. Auckland light rail, with the potential to be the biggest and among the most transformational infrastructure investments in New Zealand's history, was an obvious and compelling place for us to start. We determined that it was a good fit with the infrastructure investment model and of the various projects considered had the most potential to be commercially attractive.

Auckland Light Rail

As you will be aware, we sought to apply the above model to Auckland's Light Rail and remain open to reengagement with Government on the original premise of NZ Infra delivering the project. We believe that the Ministry of Transport's previous endorsement should give Government confidence that the proposal we put forward was of high quality, has already gone through a robust assessment process, and meets Government's objectives for light metro outlined in the response requirement document, including:

- accessing employment, education and communities;
- integrating and enhancing Auckland's current and future rapid transit network;
- improving the environment;
- enabling quality integrated urban communities, and;
- providing a high quality service that is attractive to users with high levels of patronage.

NZ Infra remains open to progressing to the next stage of the project, namely incorporating feedback from the assessment process, refining the design and beginning commercial negotiations on the finance and ownership model, [34]

Aside from Light Rail, we remain committed to seeking out infrastructure projects where we believe we can add value, and that meet our requirements for risk-adjusted returns, and would be happy to discuss opportunities with you in your role as Minister for Infrastructure.

Nationally significant infrastructure project regime

As part of our submission to the Taxation Working Group, we noted New Zealand requires significant new infrastructure to meet its needs and as such will require significant new sources of international capital and funding, construction skills and other operational resources to deliver it.

Infrastructure investment - international context

Our experience working with International institutional investors is that they are very interested in infrastructure assets as they look to match their long term liabilities. These investors have choices about where they invest and value certainty of the regulatory and tax environment, particularly as these tend to be very long duration assets. Other countries have been active in looking to provide that environment to attract long term investors, and New Zealand needs to make sure it is at least as attractive as those countries to attract the investment in infrastructure that we need.

Other jurisdictions, most notably Australia given its proximity to New Zealand and therefore competition for capital and resources, have dedicated tax regimes to support and incentivise nationally significant infrastructure projects. These jurisdictions provide long term certainty for investors and tax settings to encourage investors which ensure that the tax environment does not act as a barrier to investment. As the investor for such projects is really choosing between jurisdictions for its investment this suggests that the tax settings may need to be adjusted to ensure that expectations as to both the certainty of and the required return on investment are met.

Infrastructure investment policy considerations/suggestions

We believe a targeted infrastructure taxation incentive scheme would help provide certainty for investors and ensure New Zealand can compete with other jurisdictions in attracting long term capital that brings with it world-class expertise. Specific criteria would be established in relation to Government project approval including but not limited to:

- project size (i.e. a minimum spend is required);
- infrastructure projects that pass the "public utility test" and for which there is a specific agreement with the government such as public transit systems, large scale housing development, communication, energy and water reticulation assets etcetera;
- demonstrated capability to deliver world-class projects;
- commitment to contribute project expertise, and;
- alignment with the Treasury's living standards framework.

Subject to meeting required deliverables of approval, the project will receive:

- a tax rate substantially less than the prevailing corporate tax rate, say half or less, set for a meaningful part of the life of the asset;
- no further tax impost on profit distribution to both domestic and foreign investors;
- full deductibility of third party non-recourse funding;
- if tax laws are changed prior to the expiry of the term of the concession, the tax conditions relating to nationally significant infrastructure are grand-parented until the end of the concession term. For example, in the event that a capital gains tax was introduced in New Zealand, nationally significant infrastructure would be eligible for a capital gains exemption on exit;
- ability to fast track other required regulatory approvals e.g. RMA approvals, the provision of foreign skilled labour to enable rapid construction, and;
- approval is project specific i.e. it survives any change of ownership. In designing a nationally significant Infrastructure regime we need to ensure international investors are provided with certainty in relation to their tax position prior to them investing and that complexity is kept to a minimum.

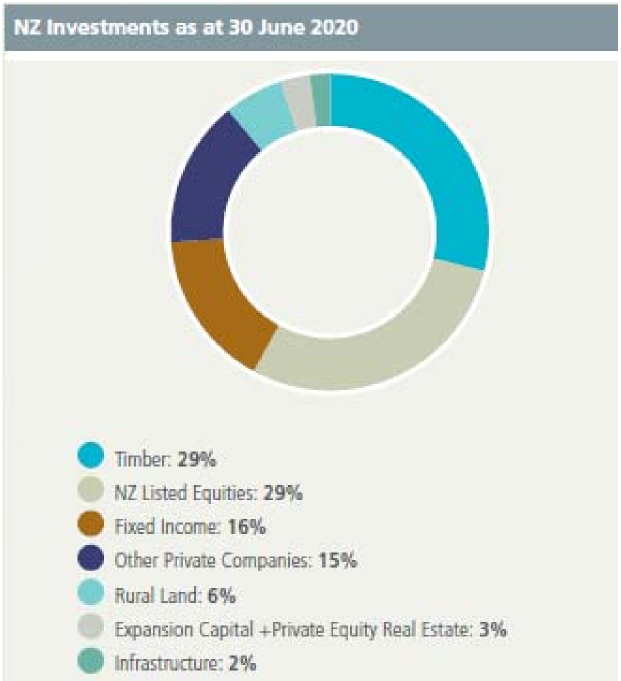
We were pleased Government picked up consideration of such a regime in its Tax Work Programme and hope the new administration gives priority to considering the matter.

6 New Zealand Investments

The Fund is one of the largest institutional investors in New Zealand and has a significant role in New Zealand's capital markets.

While we believe the Fund has a competitive advantage when investing domestically, in a global context, New Zealand is a very small investment market. For our New Zealand investments we require a return that will compensate the Fund sufficiently for the risk of concentrating too much of it domestically. As one of only a few investors of scale in the country, the Guardians also maintains a high level of price discipline

Overall, the Fund has just over NZD7.2 billion invested in New Zealand, or 18.4% of its total investments by value. To provide context about the relative size of the Fund's local investments, while New Zealand makes up just 0.1% of listed global equities, approximately 4% of the NZ Super Fund is invested in local shares. Although the dollar value of the Fund's investments in New Zealand has increased from NZD2.4 billion to NZD7.2 billion in the eleven years since 1 July 2009, the proportion of the overall Fund that is invested in New Zealand (in value terms) has reduced from 21.3% to 18.4%. The proportional drop also reflects the strong performance of global equities in recent years, even after significant new investments by the Fund in New Zealand.



The Fund's New Zealand investments are focused on four areas:

- Listed equities (managed both actively and passively via a mix of in-house and external investment managers)
- Growth capital (investments in mid-market companies on a strong growth path via external investment managers)
- Rural land (NZD400m of rural assets under management by external company FarmRight)
- Direct investments (opportunistic, large scale direct investments, managed by our in-house team). This portfolio includes sizeable investments in Kaingaroa Timberlands, Fidelity Life, Datacom, Kiwibank, hotels & property, and will shortly also include a stake in pathology provider Asia Pacific Health Group.

7 Responsible Investment

Commitment to Responsible Investment

The Guardians has a long-standing commitment to Responsible Investment (RI) and believes that environmental, social and governance (ESG) factors, including climate change, are material to long term returns. Our governing legislation also requires us to manage and administer the Fund in a manner consistent with, amongst other things, avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

ESG considerations are therefore 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. Activities include:

- Developing guidelines to integrate ESG considerations across different types of investments
- Ensuring effective engagement with our external investment managers and manager selection advisers as well as the companies we invest in
- Being an active owner of securities in which we invest by exercising our voting rights
- Considering investments which provide positive social returns in addition to the required financial return
- Maintaining a robust analytical and decision making process in response to investee companies breaching our Responsible Investment standards
- Benchmarking our performance against the Responsible Investment standards to which we aspire.

We consider ESG factors when we identify investment opportunities, assess investment risk, undertake due diligence and make decisions as an asset owner and shareholder. We also work closely with our investment managers to ensure the votes they make on our behalf our appropriate, and we aim to use our voting rights to promote best-practice corporate governance both in New Zealand and overseas.

The 5 yearly statutory review described above must address the appropriateness of our Statement of Investment Policies and Procedures and whether it has been complied with. This Statement must cover, amongst other things, ethical investment, including policies, standards or procedures for avoiding prejudice to New Zealand's reputation as a responsible member of the world community. As noted by Treasury in the Select Committee papers for our legislation, the independent review requirement was seen as a mechanism for ensuring that the Guardians' approach to ethical investment would be open to full scrutiny.

Willis Towers Watson specifically evaluated the RI Framework in relation to our obligation to manage and administer the Fund consistent with avoiding prejudice to New Zealand's reputation as a responsible member of the world community, as well as in the context of international best-practice standards. Willis Towers Watson concluded that they believed the SIPSP complied with section 61. In relation to responsible investment, Willis Towers Watson concluded that our "approach to ESG integration and stewardship is impressive, and, in our view, aligns with best practice" in activities including exclusions.

Western Sahara

In October 2020, Justice Woolford heard submissions from counsel for applicants that the Guardians had not complied with its statutory framework in respect of companies that were in some way connected to the Western Sahara. This is a complex case of interest to a number bodies other than us, our responsible minister and monitoring department. These bodies include the Ministry of Foreign Affairs, the Ministry of Primary Industries and the Fertiliser Association of New Zealand (which was granted leave to intervene). We are unlikely to have a decision handed down from the until February. [33,34]

United Nations' Principles for Responsible Investment

Our responsible investment work programme is closely aligned to the United Nations' Principles for Responsible Investment (UNPRI) – the leading global network for investors to demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

The Fund is acknowledged as operating at global best practice level, and is a regional leader in, responsible investment. The UNPRI's latest Assessment and Transparency Report rated the NZ Super Fund:

- A+ for strategy and governance;
- A+ for listed equity, property and infrastructure and A for fixed income relating to the selection, appointment and monitoring of managers;
- A for internal active listed equities, and;
- A for active ownership.

This year we were admitted to the UNPRI Leaders Group, which seeks to showcase the leadership of 36 top entities amongst UNPRI 3,500 signatories, with this year's recognition coming for climate reporting.

Other RI actions

As well as applying ESG principles when making investment decisions, we aim to run the Guardians as an organisation in a way that demonstrates good ESG practice and reporting.

We provide responsible investment resources to two other New Zealand Crown Financial Institutions: the Accident Compensation Corporation (ACC) and the Government Superannuation Fund Authority.

The Fund won the International Corporate Governance Network 2020 Global Stewardship Disclosure Awards in the Asset Owner (<£60 billion AUM) category. The awards recognise investors who provide genuine insight into their stewardship policies and how they are implemented, and whose approach to disclosure provides a model that others might follow.

In the past year the NZ Super Fund has been active in the One Planet Sovereign Wealth Fund working group to accelerate efforts to incorporate climate change considerations into the investment decision-making process and ownership activities of sovereign wealth funds.

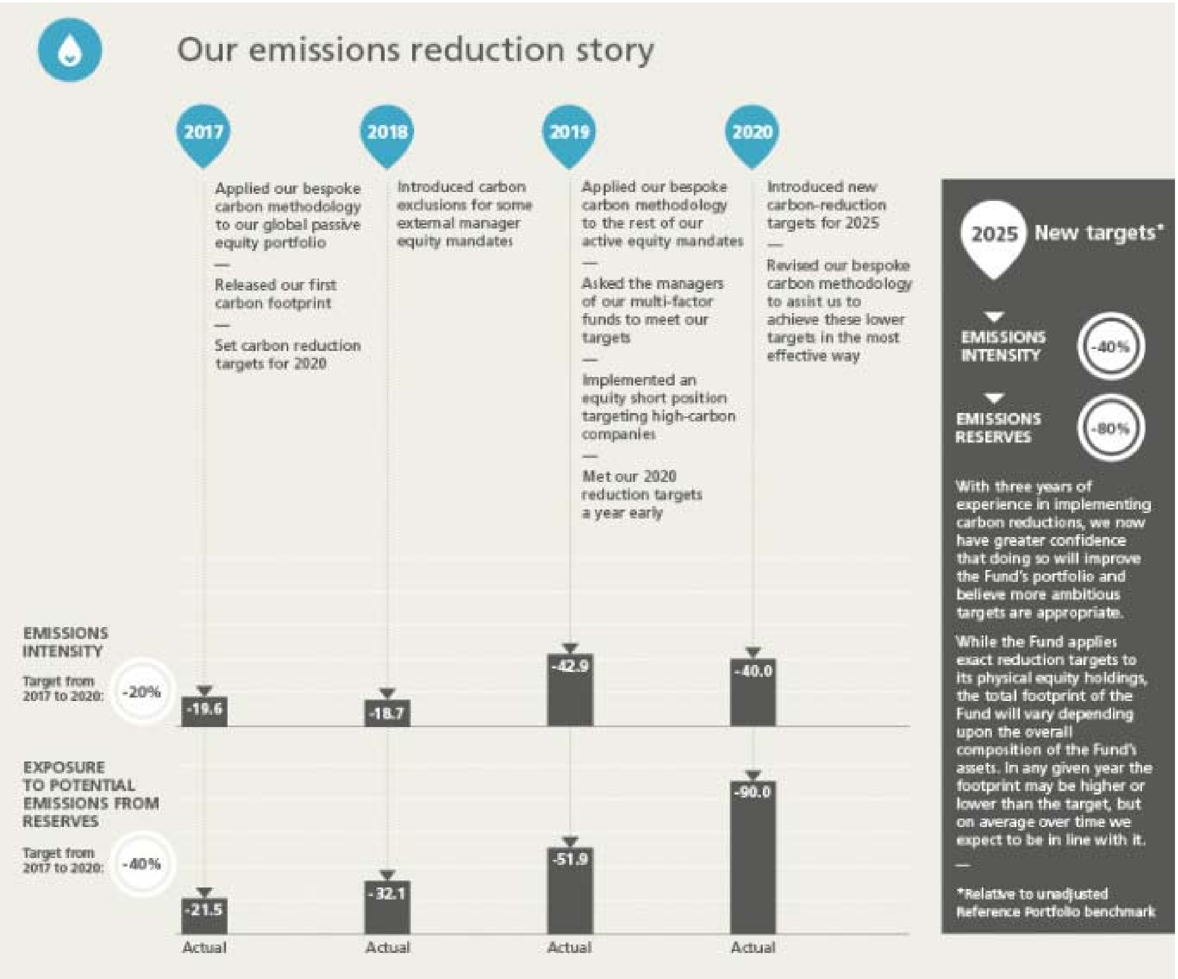
We have also played an active role on the UN Finance Commission on Modern Slavery in the finance sector, the Aotearoa Circle's Sustainable Finance Forum and co-led the Social Media Collaborative Engagement to pressure technology companies to strengthen controls to prevent the live streaming and distribution of objectionable content following the 15 March 2019 Christchurch terrorist attack.

The Fund has also been the driving force behind the New Zealand Corporate Governance Forum, a group of New Zealand institutional investors seeking to improve corporate governance amongst NZX50 listed companies to global best practice levels.

Climate Change

Given our long-term horizon, the Guardians must factor climate change into our investment strategies and ownership practices. For more than a decade, we have made it a priority to consider how the Fund's investment portfolio, and the companies we invest in, should respond to the risks and opportunities stemming from climate change. Our Climate Change Investment Strategy, announced in 2016, applies across our whole portfolio and is designed to mitigate the significant investment risks and capture the opportunities presented by climate change.

One of the core elements of our Strategy is to reduce the carbon intensity of the Fund's investments and its exposure to fossil fuel reserves. In 2016, we set targets to reduce the Fund's emissions intensity by 20% and its ownership of fossil fuel reserves by 40% by 2020. Having met these targets, we have set new, more ambitious ones: to reduce the Fund's emissions intensity by 40% and fossil fuel reserves by 80% by 2025.



On 10 September we wrote a joint letter to you along with the other Crown Financial Institutions ACC and GSF on setting out our common approach to investing in a manner that helps to account for the impact of climate change in our investment portfolios. We would welcome a discussion with you and other ministers on the joint statement and our respective climate change investment approaches in due course.

Ethical Investment Framework for government-controlled investments

We note Labour's manifesto commitment to develop an ethical investment framework for all government-controlled investments. From our perspective, in developing the framework, it will be important that the Government takes into account the practicalities of prudently and effectively investing a $47 billion fund (e.g. in respect of derivatives and collective investment vehicles) and the implications of ethical investment decisions being made by core crown to ensure that the framework does not create unintended consequences.

8 Elevate NZ Venture Fund

The Guardians has overall responsibility for the Elevate NZ Venture Fund, a Government initiative aimed at growing more innovative industries in New Zealand and lifting productivity. It aims to attract private sector investors to the domestic venture capital market and to support Series A and B investments into New Zealand companies that have moved beyond the start-up, or 'angel' investor stage.

The Guardians' role is one of governance and oversight to ensure best practice investment management in the context of venture capital markets. Elevate NZ Venture Fund is a fund-of-funds programme and is managed on behalf of the Guardians by New Zealand Growth Capital Partners (NZGCP - formerly the NZ Venture Investment Fund).

At the time of writing, Elevate NZ has committed capital to three investment funds:

- Blackbird Ventures' New Zealand fund - $21.5m (8 Sept).
- Movac 5 - $10m (23 Sept). The NZ Super Fund has also committed $70m to Movac 5.
- Pacific Channel - $20m (12 Oct).

We are engaged with Treasury as it considers a lessons-learned review of the implementation of the Elevate Fund. We will undertake a full conviction review of NZGCP next year. At this stage we are pleased with NZGCP's progress in meeting milestones in its agreed transition plan.

9 Key people

The Guardians has approximately 160 staff based at our office in downtown Auckland.

Chair: Catherine Savage

Catherine Savage has been a Guardians Board member since 2009. She was appointed Deputy Chair in 2012 and Chair in 2016. Catherine is Managing Director of Savage Group Limited and an independent director of Infratil. On the Advisory Board for Pāua Wealth Management. Previously Chair of the National Provident Fund. Served as an independent director of the Todd Family Office, Kiwibank and Pathfinder Asset Management, and earlier led AMP Capital in New Zealand. Co-Chair of the New Zealand Chapter for Women Corporate Directors. A Fellow of Chartered Accountants Australia and New Zealand, a Fellow of the Institute of Directors in New Zealand and a Fellow of the Institute of Financial Professionals

New Zealand (INFINZ). Ms Savage will be retiring from the Guardians Board on 31 March 2021, after 11 years.

Incoming Chair (and current Audit Committee Chair): Catherine Drayton

Catherine Drayton has been a Guardians Board since 2018. She will take over the Chair role on 1 April 2021. She is currently Chair of Christchurch International Airport and a director of Genesis Energy, Beca Group, Fronde Systems Group and Southern Cross Medical Care Society and Southern Cross Hospitals. A Fellow of Chartered Accountants Australia & New Zealand. Previously a director of Ngāi Tahu Holdings and of technology company PowerbyProxi (which was acquired by Apple) and Meridian Energy. Formerly the partner in charge of audit and advisory services for PricewaterhouseCoopers in Central/Eastern Europe, specialising in M&A.

Biographies of the other Board members are available at: https://www.nzsuperfund.nz/nz-super-fund-explained/governance/board/

Chief Executive Officer: Matt Whineray

Matt Whineray joined the Guardians in 2008 from Credit Suisse (Hong Kong) where he was Head of Financial Sponsor Coverage for non-Japan Asia. Prior to this, Matt was a Managing Director of First NZ Capital and a Vice President at Credit Suisse First Boston (New York). Matt began his career as a Barrister and Solicitor with Russell McVeagh. Matt co-chaired the Sustainable Finance Forum until November 2020, is a member of the Long-Term Investment Council for the World Economic Forum and on the Board of Netball NZ.