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Looking Beyond Our Shores

Tena kotou, tena kotou, tena kotou katoa
Talofa Lava, Kia Orana, Malo e Lelei, Ni Bula Sa Vinaka

Thank you very much for the opportunity to share this occasion and to celebrate the achievements of your members.

It's an honour and a privilege to be here, to be among many friends and former colleagues.

I would like to acknowledge, in particular, the Wellington branch Chair, Dr Helen Anderson, and the many distinguished guests in this room.

I was asked to give a perspective on what directors need to think about to make sure New Zealand benefits from our place in the globalised economy.

It's a great topic. We live in a very connected world.

One of the advantages we have as a country is that we are outward looking.

In a business sense, it’s because of our history as a trading nation and our limited domestic market.

Culturally, perhaps it’s because we are a country of immigrants and voyagers.

And because young Kiwis are so keen to get out and see what the rest of the world looks like.

We need to retain that **curiosity** and discipline. And we need to be more deliberate in using our endowments – talent, connectedness, environment and reputation.

There are many wonderful things about New Zealand. But we also have a huge amount to learn by **connecting** with the rest of the world.

Tonight I’m going to cover:

- the global context as I see it;
- a few thoughts on what that means for New Zealand directors and business leaders
- and run through what my experience has taught me.

Ten long years on from the GFC, the **global economic outlook has improved considerably** – even if there is much that hasn't changed (horizon and incentives)**.**

This year we have robust and broad-based global growth, with real, positive improvements across nearly every market, sector and geography.

- European and Japanese economies have finally responded to stimulatory monetary policy.

- Emerging markets look to be rebounding from the cyclical lows of recent years.

- The United States economy remains robust and supported by a strong labour market.

- There has certainly been geopolitical and political volatility, and a notable rise in populism in parts of the world, but market volatility has been subdued. Transparency and connectedness are enabling a better understanding of issues and impacts, and markets can price these risks better.

Looking further ahead -- the US is mired in internal argument and introversion, China is growing as a global force, with India not too far behind.

We have talked for years about the importance of China as a market for New Zealand. That's still true. But China has a broadening global agenda, on many fronts. One of them is expansion of influence in the Pacific region.

I was recently in Tuvalu. We counted 18 large fishing vessels in the lagoon – six being 'mother ships'. Whether Chinese or Taiwanese, this repeats itself throughout the region – with little collective thought about the implications.

Geopolitics aside, **the forces that are shaping the future global economy** include demographics, urbanisation, the environment, food production, and technology.

We have **aging populations** in many countries, including our own, but large numbers of youth in most emerging markets.

This has big implications for savings and investment, demand, and for public policy – such as pensions and health spending.

In emerging markets the middle class is growing rapidly and they are demanding global status and goods and services. This has huge implications for world resources.

Developed economies, like us, face a middle income trap – the challenge of doing **both** the same thing better, which means achieving better productivity, **and** doing better things, namely being innovative.

It is ‘easy’ to reach the production frontier, but hard to shift it sustainably.

Increased urbanisation globally also means pressure on infrastructure and changes to traditional social frameworks.

This leads to issues about national versus sub-national policies – how to support **regional development**.

We can see this in New Zealand where central and local government feuds over ownership and funding have resulted in mis-investment and lack of a clear strategy.

So there is a need to **find new models of finance for public sector goods** – especially connecting the supply of capital to infrastructure demand.

The **environment** will only continue to grow as an issue. Sustainable production will become the new **minimum standard** for business.

Traditional food production systems will be challenged. As technology develops there may be new food options available and methods of production.

United Nations population projections are that the global population will increase nearly 33% from 2015 to more than 9.7 billion people by 2050.

Artificial meat, anyone?

For New Zealand, there will be upsides but there could also be downsides.

There will be demand for peace and tranquillity in a sustainable environment.

There will be great opportunities for premium products produced in a clean green environment – ‘know your food’.

But what if there are cheap replacement foods produced closer to their markets?

We have already seen debates in our markets about food miles. The increase in the **conscious consumer** will force producers not only to improve practices but to be transparent about what they do.

Then we have the wave of disruption that is coming from **technology**: robotics, automation, Artificial Intelligence, big data.

All have implications for production and distribution frameworks and service channels.

For the future of work.

For returns to the owners of capital versus labour – which is stretched to extremes at present within and between nations

They will create huge opportunities –

But there may also be challenges as governments seek to manage the new environment – especially social cohesion.

I want to focus on **climate change** in particular. We have seen two steps forward from most of the world and a step back from the United States.

But the move to a low-carbon global economy is now inevitable because **finance** is moving.

This was the big step that took place with the Paris Agreement in 2015 – supported 197 countries and now ratified by 169.

It wasn't only Governments that were there and paying attention. It was business and the finance sector, which also agreed to take action.

The Task Force on Climate-Related Financial Disclosures was set up at the same time as the Paris Agreement was reached.

If you have any doubt, look at its membership and expert contributors: the big banks, the big accounting firms, Bloomberg, Moody's, Standard & Poor's, stock exchanges.

The US is responding, as well, in spite of what its President might say. State governments are taking action, even if the Federal government is not. And 582 US companies, including Google, Walmart and GM came out in support of it,

Some people see climate change as an ethical issue.

We see it as a question of **investment risk**. We have analysed the market and we believe that asset prices do **not** properly reflect carbon risk, over the timeframes relevant to us as a long term investor.

The risk comes from assets that might be stranded as the market moves to new technologies, as the prices of carbon intensive stocks fall.

Or because of Government policy changes and regulation.

Climate change presents a **material investment risk**.

In August this year we announced that the Super Fund's $14 billion global passive equity portfolio is now low-carbon. This represents **40% of our whole portfolio**.

The transition involved reallocating NZ$950 million away from companies with high exposure to carbon emissions and reserves into lower-risk companies.

As a result, the Fund's carbon emissions intensity reduced by around a fifth.

We have further work to do, but we are making good progress. We'd like to reduce the Fund's carbon reserves by a further 20% by 2020, and we're looking for new investment opportunities coming out of the global shift to a low-carbon economy.

At the NZ Super Fund, we have a long-standing commitment to engaging with companies about environmental, social and governance risks - ESG.

We believe these factors are material to long term investment returns and, as an intergenerational, New Zealand investor, we'll be invested in many of the companies you lead for decades to come.

We **firmly believe** that **engagement on ESG risks** – rather than exclusion – is the best approach.

It is more effective in getting companies to improve their policies and practices, and it fits with our active investment approach and our long term horizon.

At this point, I'm going to borrow some thoughts from Philippe Joubert, who spoke at the recent Responsible Investment Association of Australasia conference in Auckland.

He is Special Envoy for Energy and Climate for the World Business Council for Sustainable Development, and is founder and Chief Executive of Earth on Board. Earth on Board runs a programme through the University of Cambridge Institute for Sustainability Leadership.

Philippe has some simple messages for business owners:

- **Business cannot thrive in a world that’s in a shambles**, with disruptive weather events, water shortages and declining resources.
- **Companies have a critical role to play in securing a better world** - deploying their unique capacity for innovation and impact at scale to lead the profound transformation that is needed.
- **Boards have a duty – a fiduciary duty** - to take a lead.

Directors understand about fiduciary duty. The shift that is happening is to accept that **your fiduciary duties extend to ESG questions because they affect returns**.

The questions Board members should be thinking about include:

- As a Board, **do you spend sufficient time on social and environmental issues** to identify material risks and opportunities?
- Are you **engaging regularly with your stakeholders**, understanding their expectations?
- **Are you prepared for new carbon disclosure** and other reporting requirements?
- **Are you enabling management** and ensuring they focus on the right issues?

There is a growing view around the world that **asset ownership is about more than short-term profit maximisation.**

An ideal market includes a mix of investors with different investment time horizons and investment strategies. Time horizons will always vary by industry and asset type.

But across all industries, **long-term thinking** goes beyond a product cycle and beyond a typical investment cycle.

Recent research suggests that short-term strategies and behaviours have become entrenched in today's markets. That **short-termism** has become a problem for the global financial system.

A 2014 survey conducted by McKinsey & Company found that senior executives were seeing increased short-term pressure on financial performance -- notwithstanding their belief that **a long-term approach is a key driver of company performance**.

Long-term investment is good for economies. It can curb market dysfunction, be counter-cyclical and can provide a source of liquidity when other sources dry up.

A long-term investor does not have to base investment decisions solely on the returns expected over one or two year period.

A long-term investor can focus on intrinsic value and acts more like an **engaged business owner** rather than just looking for returns.

At the start of this talk, I mentioned the importance of New Zealanders retaining our curiosity – **being outward-looking and engaged in the world**.

Insularity will get us nowhere.

One of the first things I did when I became CEO of the NZ Super Fund 10 years ago was to **connect with peers and similar organisations** around the world.

Meeting up with colleagues from other sovereign wealth funds, pension funds and institutional investors helped me gain an understanding of **different ways to operate and of the issues my own organisation would face.**

Today, I encourage all of our senior managers and staff at all levels to do the same.

Many of the things we have achieved at the NZ Super Fund over the past 10 years go back to that.

Being willing to connect, learn and share.

It means being open with others – about what you do, the challenges you face and share your own knowledge with others.

These connections enable us to **stand on the shoulders of others.**

So we don't repeat mistakes that have been made.

And we can learn from the best practice of others.

I have become involved in several international organisations because of the opportunities to learn and to share.

These include the International Forum of Sovereign Wealth Funds, the Pacific Pension Institute, and Focusing Capital on the Long Term.

The single most important thing I have learned from my exchange with colleagues and peers around the world is the importance of **clarity of purpose.**

At the NZ Super Fund, we have a single, clear purpose. We have a strong focus on what our job is. Saving now for the benefit of future generations.

I often say this: we are **blessed by our mandate**.

As the Guardians, our founding legislation requires us to invest the Fund on a **prudent, commercial basis** and to manage it in a manner consistent with:

- **Best-practice** portfolio management
- **Maximise return without undue risk**
- **Avoid prejudice to New Zealand's reputation** as a responsible member of the world community

We have a double arm’s-length Governance framework. We are an autonomous Crown entity, legally separate from the Crown.

What that means is that we have **operational independence**. This has been crucial in allowing us to chart our own course.

Our **clarity of purpose** is a key reason why we have been able to produce consistently good returns.

We are an investor with a long horizon.

We are very happy when we get a great result, but we less concerned about the results in any one year than what we achieve over the 10 and 20, even 30 year timeframe.

As a long-term investor, we can choose to invest in a wider range of investments than a short-term investor might consider, including riskier and illiquid assets.

We can ride out the highs and lows of market movements.

We can be persistent through periods of short-term underperformance.

This means **returns can go down, as well as up**. That can be very hard for our stakeholders to understand, as we found when the GFC hit.

Long-term investing is not just about the horizon over which you hold an investment or measure returns. It is also about the control you have over capital: your independence, purpose, mandate and liquidity profile.

It also means there are no externalities resulting from your work – all impacts are owned by you – society, environment, culture.

I **do** see other sovereign wealth funds around the world who struggle with multiple mandates or mixed purposes.

Or whose purpose is changed along the way because of a change in the political context. For example, funds set up for a long-term savings goal being diverted into short-term stabilization during times of economic difficulty.

This type of dual target and short-termism is the enemy of true long-term performance.

The other most important thing I have learned is the value of **transparency, openness, accountability.**

These standards are becoming the **norm internationally**, the essential navigation point for all businesses.

For the NZ Super Fund, I consider that transparency, openness and accountability are **our licence to operate**.

That applies to what we do at home, and when we want to invest in other countries.

As investors, we should aim to be **trusted local partners and leaders in governance**.

I believe in the importance of international networks.

But I also believe we at the Super Fund have a part to play in our home patch.

We are already a major investor in New Zealand – in farming, forestry, listed companies, expansion capital, housing.

We are excited about the prospects in New Zealand for building these sectors and adding to them. I am excited about the ways that we can access these investments – through partnerships with Maori in particular, who share our focus on the long-term.

We already have a partnership with Ngāi Tahu in a new housing development at Hobsonville Point in Auckland, which includes affordable homes.

We have set up an investment hub specifically to find ways to develop a pipeline of opportunities. And we have assisted in the creation of an Iwi collective investment fund to co-invest alongside us, and others.

New Zealand is obviously tiny in the global context, but we believe we have a home advantage.

New Zealand also has a home advantage in the **Pacific**. This is our part of the world, where – while we don't have a perfect record – we do have relationships, networks and similarities.

Our Pacific neighbours face some huge issues – including threats to their very existence from rising sea levels.

They have big needs – such as infrastructure – and they have some important resources, such as fishing.

We are increasingly working with a collective of pension and sovereign Pacific funds on issues of joint interest.

I am currently the chair of the International Forum of Sovereign Wealth Funds. My vision for IFSWF is what I call the three Cs:

- Compare
- Collaborate
- Co-invest

By getting together, we can **compare best practice directly and learn from each other's experiences**. This is important because it enables us to communicate with our stakeholders in an informed way and to explain where we stand in the global context.

It gives us the opportunity not only to improve what we do as individual organisations, but to be leaders in investment practice.

Collaboration is important also. It means that we can work together to achieve more than we can do on our own.

It makes us more effective institutions and allows the best of our thinking to come to the fore.

The final C is **co-investment**. As funds increasingly look to diversify their investment approaches, it makes sense to for like-minded peers with aligned interest to pool resources and build capabilities.

Co-investment allows us to share risk and invest in smaller or new jurisdictions.

But co-investment is not easy. It requires a lot of trust. And to build trust means that we have to be open and transparent with each other. This takes personal relationship building, not just at CEO level, but throughout the whole institution.

Being connected and building **relationships** is at the core.

My summary thoughts are:

- Companies must take more long-term ownership of all their activities – it is the Board’s role;
- New Zealand needs to embrace a global reputation of long-termism, and sell it; and
- We can start with climate and our culture at the company level.

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