

Office of Hon Bill English

Deputy Prime Minister
Minister of Finance
MP for Clutha-Southland

25 MAR 2013

Gavin Walker
Chair
Guardians of New Zealand Superannuation
P O Box 106607
AUCKLAND 1143

Dear Gavin

ANNUAL LETTER OF EXPECTATION

I am writing to convey my expectations of the Guardians of New Zealand Superannuation (Guardians) as it begins planning for the 2013/14 Statement of Intent (SOI).

Priority Expectations

- *Shareholder Returns:* A prime focus for shareholding Ministers is that Crown Financial Institutions (CFIs) achieve their long term performance objectives. The Crown has a long term perspective on returns, and acknowledges that returns will vary from year to year, sometimes due to temporary or non-controllable factors. Emphasis will continue to be placed on longer term returns. In circumstances where the longer term return is persistently below the performance objective, I expect the CFI will review the appropriateness of its investment strategy. Furthermore, where active management or other value adding strategies are employed, achieving returns in excess of benchmarks after investment management fees and other operational costs is expected.
- *Investment Management Expenses:* Notwithstanding the expectation for CFIs to outperform investment objectives after investment management costs, each CFI should also ensure that the costs incurred in implementing its investment strategy are appropriate in the context of managing Crown assets.
- *Investment Review:* We expect SOEs/Crown entity boards to review major past investment decisions to assure themselves that the benefits claimed when such decisions were made are in fact being realised. Our expectation is that such reviews are made available to shareholding Ministers. The CFIs are increasing investment in non-listed investments and we think scrutiny by the shareholder for the larger investments is warranted.
- *Joint Ventures:* While shareholding Ministers are supportive of SOEs/Crown entities entering into joint venture (j.v.) arrangements as a way of leveraging expertise and capital, the expectation is that Ministers are informed at an early stage of any j.v. formation, particularly where the j.v. involves another New Zealand government entity or where it includes a foreign government or sovereign wealth fund.
- *Use of derivatives:* The aggregate funds managed within the CFI portfolio continues to grow as a percentage of the overall Crown's balance sheet. In addition, I am aware that there is an increasing use of derivative instruments within the portfolios. Together with

other Crown operations (such as the Debt Management Office and the Reserve Bank of New Zealand) this is resulting in a steady increase in the Crown's exposure to counterparties as a result of derivative positions taken. This exposes the Crown to increasing financial and credit risk. While my officials will be working on this issue in more detail, it is my expectation that CFIs should use derivatives judiciously, and that where relevant, there is a strong case for their use relative to equivalent physical exposures.

- *Collaboration:* There is a broad state sector initiative to achieve efficiencies and system-wide improvements through improved inter-agency collaboration through the Better Public Services programme. While the individual objectives and investment strategies differ across the CFI portfolio there is a material level of crossover in the operational investment activities of the CFIs. I understand that a CFI collaboration group has been established to promote knowledge and resource sharing for the benefit of the Crown. My expectation is that the CFIs will continue to identify opportunities and implement strategies to achieve operational synergies and cost efficiencies through sharing of resources and intellectual capital.

Entity Specific Expectations

- Subject to no unforeseen issues, I expect the legislative changes currently being progressed with respect to section 59 (No controlling interests) and other minor clauses will be enacted towards the end of the year.
- The Guardians are due for another independent performance review in 2014, in accordance with section 71 of the New Zealand Superannuation and Retirement Income Act. I expect to engage with you on the terms of reference for the review in early 2014.

General Expectations

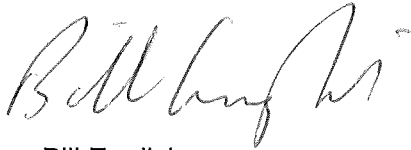
Expectations in previous years' expectations letters continue to apply in 2013/14 and the forecast period. Particular regard should be given to the following:

- *Draft Statement of Intent (SOI)/Business Plan:* All SOEs/Crown entities are expected to provide Ministers with a draft SOI and Business Plan by **1 May 2013**, at the latest.
- *OIA requests:* The Office of the Minister of Finance is to be advised by the entity when it receives a request under the Official Information Act and of the proposed response.
- *"No surprises" policy:* I expect you to maintain the "no surprises" policy and to inform me well in advance of any material or significant events, transactions and other issues that could be considered contentious or attract wide public interest, whether positive or negative.

Engagement

My expectation is that you and your executive will continue to engage openly with officials from the Treasury's Crown Ownership Monitoring Unit (COMU) during the year. An important emerging issue for the Crown is the continued increase in the aggregate size of the financial assets managed by the CFIs with respect to the total Crown balance sheet. This is raising a number of issues, including the use of derivatives as mentioned above, that COMU will be evaluating and I expect them to discuss these with you and your executive during the course of the year.

Yours sincerely



Hon Bill English
Minister of Finance

cc Adrian Orr
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