



## Office of Hon Bill English

Deputy Prime Minister  
Minister of Finance  
MP for Clutha-Southland



12 MAR 2014

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 2014/15 Statement of Intent (SOI).

#### Priority Expectations

- *Returns:* A prime focus for 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 to 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 CFI 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 Ministers. The CFIs are increasing investment in non-listed investments and we think scrutiny by the owner for the larger investments is warranted.
- *Joint Ventures:* While Ministers are supportive of CFIs 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. 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. 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:* 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. 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.

### **Expectations Specific to the Guardians**

- I expect that the New Zealand Superannuation and Retirement Income Amendment Bill, which will allow the Guardians to control special purpose entities that help facilitate investments, will be passed this year.
- Section 71 of the New Zealand Superannuation and Retirement Income Act requires that an independent performance review must be carried out by October 2014. My experience is that these reviews provide Ministers with the opportunity to be more engaged and informed owners, and should result in a shared view on the entity's objectives and accountabilities. For this reason, I may seek to extend the scope of the review's terms of reference beyond the statutory minimum.
- I appreciate your response to my 2013 letter regarding the judicious use of derivatives and the additional information which you recently provided to the Treasury. I am keen to see this discussion continue.

### **General Expectations**

Expectations in previous years' expectations letters continue to apply in 2014/15 and the forecast period. Particular regard should be given to the following:

- *Draft Statement of Intent (SOI) and Statement of Performance Expectations (SPE):* All CFIs are expected to provide Ministers with a draft SOI and SPE by **1 May 2014**, 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 the Treasury during the year.

Yours sincerely



Hon Bill English  
**Minister of Finance**

cc Adrian Orr  
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