

Guardians of New Zealand Superannuation – Five-yearly Independent Review

Response Update June 2020

Recommendations		Guardians' Response July 2019	Update June 2020
1.	<p>The Guardians should review its beliefs, values and strategic principles:</p> <ul style="list-style-type: none"> ▪ The Board should review its high level investment beliefs; ▪ Management should identify and document their organisational beliefs, values and strategic principles; and 	<p>We agree with this recommendation and note that some of this work is under way:</p> <ul style="list-style-type: none"> • The Board will review our existing investment beliefs in parallel with the Reference Portfolio review currently in progress; • We will articulate a more explicit set of organisational beliefs and strategic principles. We have recently redeveloped and launched new Values; 	<ul style="list-style-type: none"> • Investment beliefs A review of investment beliefs has been completed. This involved internal workshops with the investment team, discussion at the Investment Committee and a Board strategy session held in November 2019. The Board approved the revised investment beliefs in February 2020. We have summarised what each belief means to how we invest. Other changes include clarification to wording and removing duplication. The most significant changes were to strengthen the ESG belief and to add a new column explaining how the investment beliefs impact the portfolio. • Organisational beliefs Work on explicitly articulating our organisational beliefs has been delayed. Review work underway on the Guardians' 2020-21 strategic plan, the Responsible Investment Compass, and the People Strategy is providing ground work for identifying these beliefs.

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	<ul style="list-style-type: none"> This work should include consideration of stakeholder expectations and particularly the sponsor (Crown's) position. 	<ul style="list-style-type: none"> Work to develop a fuller understanding of external stakeholder expectations is ongoing, and will build on recent stakeholder surveys. 	<ul style="list-style-type: none"> Stakeholder expectations Deeper consideration of stakeholder expectations is under way as part of Communications strategy activities. Communications resources have increased to allow for further stakeholder engagement. This will be an ongoing process. The Guardians will continue to engage regularly with Treasury on stakeholder matters. The Treasury meets with the Board on an annual basis.
2.	The Guardians should review its compensation structure, to assist with developing a stronger employee value proposition.	Agree. A Board-sponsored remuneration structure review is under way, including the compensation structure, and this is a strategic activity for 2019-20, due for completion by end June 2020.	<ul style="list-style-type: none"> Remuneration Review The remuneration review carried out through 2019-20 has been completed. The review included internal and external assessments of the current state, a review of relevant peer organisations, confirming key remuneration and bonus design principles, and implementation actions and timelines from July 2020.
3.	The Guardians should make greater use of a risk factor framework, as an additional lens through which to view the portfolio and for highlighting diversification opportunities.	We have explored the use of risk factor frameworks and employed them to test the additional understanding they provide. We came to the conclusion that such frameworks did not greatly increase insight into the portfolio compared with our risk budgeting process. However we have found macro risk factor work to be helpful as part of our investment environment and scenario analysis and will build on that work.	<ul style="list-style-type: none"> Risk factor frameworks No further actions required.

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4.	The Guardians should allocate more resources to focus on responsible investing (RI) issues.	Agree. RI is important for long-term outcomes and we are currently assessing resource needs. Our dedicated team of three RI professionals has substantial support from the investment team, because the RI framework is integrated through the investment process.	<ul style="list-style-type: none"> Responsible Investment We have increased the size of the Responsible Investment team, with recruitment of an additional full-time RI professional, increasing the RI team to four (recruitment is still under way). In addition, we have had a summer internship, which has been extended part-time basis for six-months to September 2020. Resourcing requirements for RI will continued to be monitored.
5.	The Guardians should make greater use of reverse stress-testing or “pre-mortems” to develop responses that would prevent capitulation of the current portfolio construction and active risk approach, under a small number of extremely adverse (but plausible) scenarios.	Agree. We use stress-testing in a range of areas and will look for further opportunities to employ these techniques.	<ul style="list-style-type: none"> Stress testing The Investment Environment report is being restructured to make it possible to include a wider range of scenarios, including stressed scenarios. The Reference Portfolio review carried out in 2019-20 included the development of a new Reference Portfolio model, which was independently reviewed. The model was used to test a wider range of scenarios. At its February meeting, the Board had a session on the potential impact of a long period of low or negative interest rates. We also apply regular stress tests/pre-mortems to the portfolio as part of our Funding and Treasury Group activities. The most recent test in February 2020 considered a combination of a cyber-attack, bank failure, reductions in liquidity, a triggering of market circuit breakers and market closures. The Covid-19 pandemic has been a major real-life stress test and the portfolio performed as expected.

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	Governance		
1.	The Board could benefit from greater use of external advice, particularly on issues that are highly complex or contentious.	The Board does obtain external advice when it believes these advisers can add value to discussions. Individual Board members are also active in a number of international and peer forums, which provide regular best practice insights. We will continue to look for further opportunities for external perspectives.	<ul style="list-style-type: none"> • Board external advice This is ongoing. The Board has had two sessions with external advisors since November 2019 on investment and remuneration matters, and has two more scheduled for 2020 on investment and portfolio topics.
2.	Management could give greater attention to identifying and reducing bias in decision-making. This should include consideration of the role that new technologies can assist with this process.	Agree. We have been improving awareness of bias-risk across the team through education programmes on bias and inclusion, and have been strengthening our recruitment and development processes. We will also consider tools and processes to reduce the influence of bias.	<ul style="list-style-type: none"> • Bias in decision-making This is ongoing.
3.	We support the Guardians' plan to introduce a holistic approach to assessing all Fund risks (investment and enterprise risks) and for bringing the key risks to the Board's attention. We suggest that the same principles could be applied to the dashboard reporting, with the major issues from these highlighted in a	Agree. As Willis Towers Watson notes, the dashboard reports are very comprehensive, and we need to periodically check that key information can be readily identified by recipients.	<ul style="list-style-type: none"> • Dashboard reporting This is ongoing.

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	manner which helps them to stand out.		
	People Model (Culture)		
4.	Management and the Board could do more to maintain and evolve the cultural effectiveness of the organisation.	We note that elsewhere in its report, Willis Towers Watson observes that the Guardians already has a strong culture and this recommendation is made in that context. Culture has been a major focus for the Board and Management for some years, and we continue to invest substantially in this area. We see this recommendation as an endorsement of work already under way.	<ul style="list-style-type: none"> • Cultural effectiveness The Board and Leadership Team have kept a focus on cultural effectiveness with several Human Resources initiatives in 2019-20, including design and completion of a culture survey, implementation of new values, the employee value proposition developed and talent development programme being rolled out as a multi-year programme. This is an ongoing area of work.
5.	The Guardians could act to strengthen diversity, e.g. through observing the experiences of leading peer funds and corporates, in order to learn more about diversity mechanisms which produce both better outcomes and better culture.	Agree. We have several workstreams under way, including formal training programmes, enhanced recruitment processes, a comprehensive leave and benefits programme designed to further diversity objectives, and ongoing engagement with peer funds.	<ul style="list-style-type: none"> • Diversity This is ongoing.
6.	Greater consideration could be given to scenarios as part of the Long Term Target State review by considering changes in the investment “ecosystem”,	Agree. This will be an input to ongoing strategic conversations on the longer term target state.	<ul style="list-style-type: none"> • Scenarios in Long Term Target State review This is ongoing.

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	e.g. the evolution of private markets investing, the application of new technologies and the state of capitalism.		
	Investment Model <i>The Board could:</i>		
7.	Consider whether it remains comfortable with the Management team making a recommendation on the choice of the most appropriate reference portfolio.	The Board has considered this recommendation and confirmed that it is comfortable with Management including a recommendation, as part of the range of options presented to the Board.	<ul style="list-style-type: none"> • Reference Portfolio review recommendation Completed in November 2019. No further actions required.
8.	Confirm that it remains comfortable with the proportion of the active risk budget allocated to the strategic tilting programme.	The Board considered the proportion of the active risk budget allocated to the strategic tilting programme in June 2019. The Board is comfortable with the budget allocated to strategic tilting. The Board considers the risk tolerance on strategic tilting at each risk budget review and oversees the programme via reports at each Board meeting.	<ul style="list-style-type: none"> • Strategic tilting active risk Completed. No further actions required.
9.	Assign greater time to strategic dialogue on RI issues and the oversight of Management's RI actions.	Agree. This will be actioned.	<ul style="list-style-type: none"> • Board dialogue on RI The Board has continued to spend time discussing RI at its regular meetings, education and strategy sessions. The Board has had held several sessions on

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			the Climate Change Investment Strategy, the wider RI strategy and further discussions have been scheduled.
	Management could:		
10.	Review the long-term cash rate assumptions as part of the next reference portfolio review.	Agree. This is being done as part of the current Reference Portfolio Review due to be completed by June 2020.	<ul style="list-style-type: none"> • Long-term cash rate assumptions This was considered as part of the Reference Portfolio review which has been completed.
11.	Review the case for having a 100% hedged portfolio as part of the next reference portfolio review.	Agree. This is being done as part of the current Reference Portfolio Review due to be completed by June 2020.	<ul style="list-style-type: none"> • Hedged portfolio This was considered as part of the Reference Portfolio review which was has been completed.
12.	Consider whether the ex-post returns to date are consistent with the Guardians' beliefs on the reliability of mean reversion in the different asset classes used in the strategic tilting programme.	<p>The programme performance is monitored at both the aggregate and asset class level against our expectations. We believe the performance to date, which is greater than our return expectation, provides endorsement of the reliability of mean reversion across the programme.</p> <p>Furthermore, we conduct reviews of the inputs to the valuations and risk budgets across each asset class and that provides the opportunity to adjust our assessment of mean reversion as needed.</p>	<ul style="list-style-type: none"> • Mean reversion Performance in Strategic Tilting is monitored routinely by the Asset Allocation team and is an ongoing activity. No further actions required.
13.	Consider whether the current level of rigour and detail required in the compliance and attestation	Agree. We note that there is an important balance between rigour, efficiency and innovation. As part of the current Risk Culture work programme we are reviewing our	<ul style="list-style-type: none"> • Compliance vs creativity The Guardians has reviewed its approach to the compliance and attestation process, including

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	process is having the undesired effect of stifling creativity.	approach to compliance and periodic attestation.	workshops with staff. The goal has been to simplify compliance processes, while ensuring that controls are meaningful and well-understood by the team. A new simplified attestation process has been developed and this was presented and approved by the Board at the February 2020 meeting, and is being implemented in 2020. We are also implementing improvements agreed as a result of a review of risk culture carried out in 2019, including improved staff communication and engagement on risk.