

3 April 2013

Hon Bill English
Minister of Finance
Parliament Building
Private Bag 18888
WELLINGTON

Dear Minister

ANNUAL LETTER OF EXPECTATION

Thank you for your letter of 25 March 2013 setting out your expectations of the Guardians and of the content of our 2013/14 Statement of Intent.

Shareholder Returns

We note your focus on the importance of Crown Financial Institutions (CFIs) achieving long-term performance objectives and, where active management or other value-adding strategies are employed, achieving returns in excess of benchmarks.

The Fund's expected rate of return is to outperform 90-day Treasury Bills by 2.5%, averaged over rolling 20-year periods. We also measure the success of our active and value-adding strategies by comparing the Fund's returns to a notional, low-cost, passively-managed Reference Portfolio. Our expectation is that the Fund will comfortably exceed the returns of the Reference Portfolio over a rolling 20 year period.

With regard to measuring performance, for your information, the Fund has comfortably exceeded its performance expectations since inception and over shorter periods. A full breakdown is below.

Performance as at 28 February 2013	Last 12 months	Last 3 years	Last 5 years	Since inception
Actual Returns	17.58%	13.66%	6.26%	8.41%
Reference Portfolio Return	13.59%	10.49%	5.15%	7.67%
Treasury Bill rate	2.44%	2.59%	3.54%	5.03%
Treasury Bill rate + 2.5%	4.94%	5.09%	6.04%	7.53%

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Our investment strategies are constantly reviewed to ensure they provide the best possible use of available capital. Active investment is only undertaken when we have a high degree of confidence it will reduce the Fund's risk levels, improve returns, or both.

Investment Management Expenses

We are conscious of the need to ensure that the costs incurred in implementing our investment strategy are appropriate in the context of managing Crown Assets.

By international standards, the Fund is lower cost and creates more net-value-add than its peers (as verified by CEM, the global leader in benchmarking pension and sovereign wealth funds, most recently for the five years to December 2011). Furthermore, while the Guardians operates in a global market with a strong degree of competition for highly qualified personnel, we appreciate the importance of ensuring remuneration and costs are appropriate in a New Zealand as well as an international context.

The Guardians' remuneration framework is benchmarked to relevant New Zealand salary comparisons using third-party data. It aims to attract and retain competent people, and align rewards with the achievement of financial and non-financial targets. Further information, including a high degree of detail on this matter, is available in our 2011/12 Annual Report.

Decisions to bring investment activities in-house (which may have implications for headcount) are only made when we are satisfied that this will be a more efficient and effective approach in adding value than using an external manager.

Investment Review

The Board receives regular retrospective reviews of all investment strategies to determine if the original investment objectives have been met and to learn lessons from what has happened compared with pre-investment analysis. We agree that transparency and shareholder scrutiny of the success of major investments is desirable. We will continue to share the results of our reviews of major non-listed investments as part of our quarterly reporting to you and via our Annual Reports.

Joint Ventures

The expectation that you be informed at an early stage of joint venture arrangements, especially where the arrangement involves another New Zealand government entity, foreign government or sovereign wealth fund, is understood and noted.

Use of Derivatives

We acknowledge your expectations that we use derivatives judiciously, and that where relevant, there is a strong case for their use relative to equivalent physical exposures. The Guardians operate a transparent framework for both assessing the relative value of using a derivative versus a physical exposure when investing, and identifying and managing the relevant risks associated with each instrument. Investment professionals from the Guardians have recently met with our key Treasury relationship manager outlining, amongst other things, our derivatives framework. We will oversee and support further engagement and knowledge-sharing with Officials.

Collaboration

We remain committed to driving the collaboration efforts amongst CFIs to promote knowledge and resource sharing. Collaboration amongst CFIs and our global peers is a key strategic priority for the Guardians.

Entity Specific Expectations

We thank you for progressing the legislative changes currently underway with respect to Section 59 and other minor clauses of the New Zealand Superannuation and Retirement Income Act 2001. The legislative changes requested are important to the Guardians, as they remove some significant impediments that hamper achievement of our mandate. It is very pleasing to see the legislative change process progressing. We appreciate your on-going support and look forward to enactment later in the year.

We also note the forthcoming independent performance review in 2014 and look forward to discussing its Terms of Reference.

Yours sincerely



Gavin Walker
Chairman