



2016/17 Annual review of the Guardians of New Zealand Superannuation

Report of the Finance and Expenditure Committee

March 2018

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Guardians of New Zealand Superannuation

Recommendation

The Finance and Expenditure Committee has conducted the annual review of the Guardians of New Zealand Superannuation for 2016/17, and recommends that the House take note of its report.

Introduction

The Guardians of New Zealand Superannuation is an autonomous Crown entity established by the New Zealand Superannuation and Retirement Income Act 2001. Its purpose is to manage and administer the New Zealand Superannuation Fund on a prudent commercial basis. The fund is a long-term investment, with withdrawals to support superannuation expected to begin in 2029/30.

The chief executive officer, Adrian Orr, has resigned after 10 years in the role. We would like to thank Mr Orr for his contribution and service to the Guardians and the New Zealand Superannuation Fund, and wish him well in his new position as Governor of the Reserve Bank of New Zealand.

Financial performance

The New Zealand Superannuation Fund returned a profit before income tax of \$6,201.7 million in 2016/17, well exceeding its forecast of about \$2,568 million. This represents a 20.7 percent total return for the year. As at 30 June 2017, the fund's net assets after tax were \$34.5 billion, an increase in net assets of about \$5 billion (17 percent) compared with the previous year. The fund now stands at about \$38 billion, which is a record high. In the 13 years since the fund was established, it has returned an average of 10.22 percent each year.

We heard that the Guardians do not expect the returns to remain so high over the next several years. As returns normalise over the long term, the Guardians expect the fund to deliver average returns of about 8 percent a year.

The Auditor-General assessed the Guardians' management control environment as "very good", its financial information systems and controls as "very good", and its performance information and associated systems and controls as "very good".

We commend the organisation on these very strong results.

Investments in New Zealand

A significant portion of the New Zealand Superannuation Fund is invested offshore. This allows the Guardians to diversify the investments and invest in opportunities that would not otherwise be available because of New Zealand's relatively small market.

However, the Guardians have also added a considerable number of New Zealand assets to the portfolio, in accordance with a ministerial directive to increase the fund's investments in New Zealand, issued by the Minister of Finance in 2009. We heard that the fund's New

Zealand investments are now worth over \$5 billion, which is an increase of \$2 billion since the ministerial directive was issued.

The fund holds a 42 percent stake in Kaingaroa Timberlands, which owns the Kaingaroa forest plantation. The Guardians noted that Kaingaroa Timberlands continued to perform well, both in terms of cash returns and valuation uplift.

Among other highlights of the year, the Guardians identified their investments in Kiwi Group Holdings and insurance company Fidelity Life, as well as their commitment of \$260 million for investment in small and medium-sized New Zealand companies. They noted that investments of \$5 million to \$15 million in small and medium-sized companies present growth opportunities for the companies, which the Guardians called an “interesting market opportunity”. We also heard about investments and collaborations with iwi groups which have active post-Treaty settlement operations—particularly with Tainui, and a housing development partnership with Ngāi Tahu.

The New Zealand Superannuation Fund’s long-term outlook means that it is able to make large investments in New Zealand while weathering short-term volatility. However, the Guardians note that as they continue to invest in New Zealand, it becomes harder to find opportunities. The investments need to be on a scale that will make a difference to the performance of the fund, and the companies must be large enough to avoid the risk of the Guardians becoming a majority shareholder.

Chief executive’s remuneration

We noted that there had been some public discussion about the remuneration of the chief executive, which increased by 14.7 percent in 2016/17 to \$1,060,753, including bonuses, against the advice of the State Services Commissioner. The Guardians’ annual report explains that the chief executive’s role is unique in New Zealand. It has grown in complexity and scope, and requires original and strategic thinking and leadership. It also says that any bonuses awarded are closely linked to the performance of the fund. The Guardians believe that the salary and bonuses are competitive and appropriate when compared with those of other New Zealand companies.

When setting the chief executive’s remuneration, the board is required to work with the State Services Commission and the Minister of Finance. We heard that although the Guardians do not have as much time as they would like to consult with the State Services Commission, they believe the consultation is carried out in good faith.

We heard that the Guardians are currently hiring a new chief executive, and are working with the State Services Commission to ensure that appropriate remuneration is offered.

Ethical investments

We discussed concerns in recent years around ethical investments in superannuation funds, and asked how the Guardians have managed the fund’s investments on an ethical basis. We heard that the Guardians are guided by their “responsible investment criteria”. The criteria are designed to be measurable against international and domestic laws, New Zealand’s international protocols, and global best practice concerning labour standards, health,

welfare, and environmental standards. The Guardians make specific exclusions when investing in index funds, in line with the responsible investment criteria.

We heard that the Guardians make it very clear that prospective fund managers must act consistently with the criteria. The industry is becoming more accommodative to such requests. Many fund managers are now signatories of the United Nations Principles for Responsible Investment. This acceptance of responsible investment by the industry has made it easier for the Guardians to create ethical investment structures with fund managers.

We also heard that the Guardians' work in the area of ethical investment has helped inform smaller New Zealand funds, as they provide a list of their investments and exclusions.

Climate change strategy

Towards the end of 2016, the Guardians announced a climate change strategy for the New Zealand Superannuation Fund, after identifying that the bulk of its exposure to carbon emissions was concentrated in a relatively small group of global equities. The goal of the strategy is for the fund's portfolio to be more resilient to climate-related risks. This would be achieved by reducing the carbon emission intensity of the fund's portfolios by at least 20 percent, and reducing the carbon reserves covered by the fund's investments by at least 40 percent.

In 2017, the Guardians moved \$950 million away from companies with high exposure to carbon emissions and reserves into lower-risk companies. Passive holdings in 297 companies were sold. As of 30 June 2017, the carbon emissions intensity of the fund's total portfolio was 19.6 percent lower, and its exposure to carbon reserves was 21.5 percent lower than if the changes to its passive equities portfolio had not been made. We heard that the remaining target needed to be met by working with the Guardians' external managers. The Guardians consider this the most difficult part of meeting the target. The Guardians are now examining investment opportunities for a future affected by climate change—for example, alternative energies and alternative ways of building communities.

The strategy is not part of the Guardians' responsible investment criteria. The criteria require established policy, conventions, or law regarding ethical issues, and the Guardians do not yet consider climate change to be an ethical issue. Instead, the Guardians have identified the volatile price of carbon internationally as an undue investment risk, which means they have been able to create a climate change strategy without needing national or international policy changes.

Low Māori representation among staff

We commended the Guardians on the bilingual statements by the chairperson and chief executive in the annual report. However, we noted that only four of the Guardians' 130 staff members identify as Māori. We asked what the Guardians have done to encourage Māori into the organisation.

We heard that the organisation has become part of the TupuToa programme in recent years, which is an internship programme designed to help Māori and Pasifika graduates into the corporate and professional sectors. This means that Māori and Pasifika now make up the bulk of the Guardians' annual internship programme.

Appendix

Committee procedure

We met on 21 February and 21 March 2018 to consider the annual review of the Guardians of New Zealand Superannuation. We heard evidence from the Guardians, and received advice from the Office of the Auditor-General.

Committee members

Michael Wood (Chairperson)
Hon Amy Adams (from 21 March 2018)
Kiritapu Allan
Andrew Bayly
Rt Hon David Carter
Tamati Coffey
Hon Steven Joyce (until 21 March 2018)
Barbara Kuriger (until 21 March 2018)
Ian McKelvie (from 21 March 2018)
Willow-Jean Prime
Dr Deborah Russell
David Seymour
Fletcher Tabuteau
Dr Duncan Webb
Lawrence Yule

Advice and evidence received

We received the following documents as advice and evidence for this annual review. They are available on the Parliament website, www.parliament.nz, along with a transcript of our hearing.

Office of the Auditor-General, Briefing on the Guardians of New Zealand Superannuation, dated 21 February 2018.

Guardians of New Zealand Superannuation, Post-hearing responses.