

Highlights for the 2010 Year

Our Mission

The Authority's mission is to use best practice to manage the Fund and administer the GSF Schemes, in accordance with the GSF Act, with the prime objectives of enabling:

- returns to be maximised without undue risk to the Fund,
- the Crown's contribution to GSF to be minimised, and
- the needs and reasonable expectations of its stakeholders to be met.

Website

The Authority's website www.gsfa.govt.nz continues to be an important part of our communications strategy and contains comprehensive information on both the Authority and the Fund.

Further Information

If you have any queries regarding this letter, please write to the Authority at PO Box 3390, Wellington, 6140. For any queries regarding your membership, please direct them to Datacom Employer Services, GSF Schemes Administration, PO Box 3614, Wellington, 6140, *Freephone 0800 654 731*. Free copies of the annual report can also be obtained by contacting Datacom.



Dear Member

Following the release of the annual reports of the Government Superannuation Fund Authority (*the Authority*) and the Government Superannuation Fund (*GSF or the Fund*) for the year ended 30 June 2010, I am pleased to update you on the management of GSF.

Features of the 2010 year

- Solid investment returns.
- Surplus after-tax of \$285 million (10.4% of net assets).
- Significant added value from active management of investments.
- Further progress in diversifying the Fund's investment market exposures and manager appointments.
- A new GSF Schemes' administration system underway.

Tributes

Board members, Helen Bowie, Susie Weaver and Ralph Stockdill retired when their terms of appointment came to an end.

The Board expresses its sincere appreciation and thanks for their significant contributions, and wishes them well for the future.

We welcomed Toni Kerr and Mark Verbiest as new Board members.

Appreciations

The Board appreciates the good relationships it has with the Government Superannuitants Association and the NZ Railways Superannuitants Association.

The Board thanks the management team and staff for their work and commitment during the year.

Tim McGuinness

Chairman, Government Superannuation Fund Authority Board

September 2010

Investments

Investment markets remained very unsettled in the aftermath of the Global Financial Crisis (GFC). Markets rallied strongly through most of the year but became highly volatile toward the end, reflecting conflicting assessments of the global financial scene. The threat of a global banking collapse was averted by massive, concerted government stimulus. Nevertheless, a lot of uncertainty remains about the durability of the recovery and the capacity of governments to deal with the huge debt overhang that has been built up.

The Board continues to focus on an investment strategy appropriate for a Fund that is expected to pay pensions for the next 60 years or so. This is achieved by diversifying the Fund's exposures to growth assets and by engaging investment managers capable of adding value. The Board is constantly seeking to enhance the management of the Fund to meet the statutory requirements of best practice portfolio management and maximising return, without undue risk to the Fund as a whole.

During the year the Authority modified the way it defines and monitors its investment strategy. It developed a Reference Portfolio (RP), which is a simple portfolio which could meet the risk and performance measures (see below) by investing passively at low cost. The Authority believes that the RP is not the most efficient portfolio and that further diversification and active management decisions can make meaningful improvements to the overall risk/return trade-off. These will be reflected in a Target Portfolio that will be compared to the RP to assess whether the diversification and active management decisions have added value, net of costs.

Investment Returns

The investment performance of the Fund during the year was heartening, with solid returns across most asset classes. The Fund's surplus after-tax for the year of \$285 million represents a return of 10.4% (2009 : -16.8%) on average net assets. The Fund's before-tax return was 14.3%.

The Fund benefited significantly from active management in most of the asset classes in which it is invested. Overall, active management contributed 2.0% to the Fund's before-tax return of 14.3%. This translated into a 1.3% return net of investment management fees.

The table below compares the Fund's investment returns against the Investment Performance Measure (IPM) (see below) over periods ended 30 June.

	<i>1 year to 30 June 2010 %</i>	<i>5 years Annualised %</i>	<i>Since October 2001 Annualised %</i>
Fund	10.4	1.2	2.3
IPM	8.2	7.2	7.0

Notes:

- The Fund's IPM compares the after-tax return of the Fund with the NZX New Zealand Government Stock Gross Index return (after-tax) plus at least 2.5% per annum measured over rolling 10 year periods.*
- The Risk Parameter is to have no more than a 1 in 10 chance in any one year of a loss after-tax greater than 9.0% of the total Fund.*

The Fund return over 5 years annualised reflects the impact of the GFC on investment returns. The Fund return since October 2001 annualised reflects both the impact of the GFC and the decline in equity markets in 2000-2003.

It is important to note that the Fund's performance does not impact on members' entitlements as these are set by the Government Superannuation Fund Act 1956 (the GSF Act). Any shortfall is paid by the Crown.

Responsible Investing

The GSF Act requires the Authority to manage and administer the Fund (among other requirements) in a manner consistent with avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The Authority must also have an ethical investment policy. These matters are addressed in the Authority's Responsible Investment (RI) Policies, which also cover:

- Environmental, social and governance considerations.
- The retention, exercise and delegation of voting policies.

In terms of its RI Policies the Authority excludes direct investment in securities issued by a number of companies that are involved in manufacture of tobacco, anti-personnel mines, cluster munitions and nuclear weapons. These activities are inconsistent with the Authority's RI Policies and with international conventions to which New Zealand is a party.

The Authority and other Crown Financial Institutions (CFIs) have similar RI obligations and all are signatories to the United Nations Principles for Responsible Investment (UNPRI).

The CFI's are working closely together to ensure their RI policies are implemented consistently and economically. Much of the work is undertaken for the group by the New Zealand Superannuation Fund's Responsible Investing Unit. The Authority has also participated in collaborative engagements, both directly with the New Zealand Superannuation Fund and through the UNPRI, with companies believed to infringe the RI Policies, to encourage them to change their practices. New investments are evaluated in terms of the RI Policies as well as normal commercial criteria.

Schemes

New business system

Following a tender the Authority appointed Datacom Systems (Wellington) Limited (Datacom Systems) to undertake the development of a new and more sustainable system to be used in the administration of the GSF Schemes. The Authority is satisfied that Datacom Systems has the resources, experience and capability to undertake the work.

The project is being planned in three phases: Elaboration, Construction and Transition using an approach known as Rational Unified Process. The objectives of the Elaboration phase are to further refine the scope and technology for the new system and to give the Authority greater certainty as to the total cost of the project. The Elaboration phase commenced early in 2010, has proceeded on time and to budget, and is already achieving the objectives. This phase will be completed towards the end of 2010 at which time Datacom will move on to the Construction and Transition phases.

Schemes administration

Datacom Employer Services continues to perform well as the scheme administrator of the GSF Schemes and has met the new performance standards that applied from 1 July 2009.

Additional payment to members in receipt of CPI adjusted annuities

As part of Budget 2010, a legislative change was made whereby members, in receipt of a Consumer Price Index (CPI) adjusted annuities, will receive an additional payment, equivalent to 2.02% of their annuities, between 1 October 2010 and 27 April 2011. The additional payment is intended to provide compensation to members for the increase in goods and services tax (GST) on 1 October 2010. After 27 April 2011 the impact of the increase in GST will be reflected through the annual CPI adjustment applied to annuities from 28 April 2011.

GSFA