

Chairman's Letter 2011



Dear Member

This is my first letter to you following my appointment as Chairman of the Government Superannuation Fund Authority in August of this year.

I am pleased to provide you with an update on the management of GSF following the release of the annual reports of the Authority and GSF (or **the Fund**) for the year ended 30 June 2011.

Features of the 2011 year

- The Fund made a surplus after tax of \$335.6 million (return of 11.6%)
- The development of the new business system for administering the GSF Schemes is progressing well
- The 5 year Statutory Review completed this year confirmed the Authority meets best practice in all essential areas, has effective governance, appropriate policies and practices, strong risk management and effective decision making.

Tribute

Tim McGuinness retired as Chairman of the Board at the end of May 2011. Mr McGuinness was a member of the inaugural Board, appointed when the Authority took over responsibility for the management of GSF in 2001, and was Chairman from 2008. The Authority and GSF benefitted from his wide experience in investment and governance matters. The Board expresses its appreciation and thanks for the very significant contribution made by Mr McGuinness and wishes him well for the future.

Welcome

The Authority welcomes Cecilia Tarrant as a new member of the Board with effect from August 2011.

Thanks

The Board is appreciative of the good relationships it has with both the Government Superannuitants Association and the NZ Railways Superannuitants Association.

On behalf of the Board, I would also like to thank the management team and staff for their high level of work and commitment to meeting the Authority's objectives.

Yours sincerely,



Keith Taylor

Chairman,

Government Superannuation Fund Authority Board

September 2011

GSFA

Investments

Growth investments continued to recover for the second year since the global financial crisis, or GFC, with global equity and commodity markets up strongly. These results reflected markets' low starting points and the impact of huge economic stimulus from governments trying to avert a global depression.

Investment activity

During the year the Authority continued to diversify the Fund's sources of return and risk. In addition to existing investments in global property, commodities and absolute return strategies, established over the last few years, new investments were made in insurance-linked assets and New Zealand commercial property.

Investment performance

The Fund return was strong for the second year in a row. This year's return after tax was 11.6% (2010: 10.4%).

The Authority is pleased with the value active managers have added since the transition from passive global equity investment in 2007/08. Active management has added value in most asset classes and to the Fund overall.

The Fund's total exposure to foreign currencies was increased above benchmark for most of the year on account of the New Zealand dollar's perceived over-valuation and link to international equity markets. As a result, the Fund did not gain as much as it could have if foreign currency exposures had been maintained at benchmark.

The table below compares the Fund's investment returns with the Investment Performance Measure (IPM) for periods ending 30 June 2011.

	<i>1 year</i>	<i>Since 5 years Annualised</i>	<i>October 2001 Annualised</i>
	<i>%</i>	<i>%</i>	<i>%</i>
Fund return (after tax)	11.6	0.8	3.2
IPM*	7.2	7.4	7.1

* *The IPM is the NZX New Zealand Government Stock Gross Index (after tax) plus at least 2.5% per annum measured over rolling 10 year periods.*

The five years' annualised return includes the impact of the GFC on investment markets. The annualised return since October 2001 includes the impact of the GFC as well as the large decline in international equity markets in 2000-2003.

Outlook

There have been declines in global equity prices and the value of the New Zealand dollar since year end. These falls were a reaction to weakening growth in the US and Europe, coupled with a loss of confidence in policymakers' capacity to fix the debt crisis overhanging the developed economies. The investment risks are therefore considered to be higher than usual and it is unlikely the outlook will improve significantly until the debt problem is addressed credibly.

As always, it is important to note that the investment performance of the Fund does not impact on members' entitlements.

Schemes

Schemes administration

The scheme administrator, Datacom, continues to perform well and has met the performance standards that have applied since 1 July 2009. These performance standards reflect current best practice in administration of defined benefit schemes and are specific in terms of required turn-around times.

New business system

Good progress is being made on the development of a new and more sustainable business system for administering the GSF Schemes. The current system is more than fifteen years old and uses technology that is no longer in common use in New Zealand.

The detailed requirements for the project were largely completed in December 2010 and the developer, Datacom Systems (Wellington) Limited, is now building the new system which is expected to be completed around June 2012. Initial planning for the transition phase has already begun.

Statutory Review

Our legislation, the Government Superannuation Fund Act 1956 (**the GSF Act**), provides for a review to be conducted every 5 years to assess how effectively and efficiently the Authority is performing its functions. The first review was undertaken in 2006 and the second review was completed in 2011.

The Minister of Finance appointed JANA Investment Advisers (**JANA**) to conduct the second review.

In tabling their report in Parliament, the Minister of Finance stated: ‘The reviewers found the GSFA (**the Authority**) meets best practice in all essential areas, has effective board and management oversight, appropriate policies and practices, strong risk management and effective decision making.’

In their report JANA stated:

- The Fund’s investment objectives and strategy have been developed based on sound principles using a logical and consistent approach.
- The investment performance of the Fund to date has been satisfactory.
- The portfolio construction approach pursued by the Authority has resulted in a reduction in the risk profile of the Fund’s returns.

In terms of organisation and governance, schemes administration, and information and financial management, JANA concluded that the Authority is well structured and well managed with appropriate systems in place or under development.

JANA made a number of recommendations and suggested enhancements which have been largely accepted by the Board. Action plans have been put in place where appropriate.

The JANA report can be viewed on The Treasury website at <http://treasury.govt.nz/releases/2011-07-28>

The Authority’s specific responses to the comments made by JANA in the Executive Summary of their report, and on their recommendations and suggested enhancements to policies and practices, are available for review on the Authority’s website at www.gsfa.govt.nz.

Recent and Pending Law Reforms - Authority Exemptions

Members may have seen in the media that, during the year, a number of law changes were made to help restore public confidence in New Zealand's financial markets and in the professionalism and integrity of financial service providers. Other changes have been proposed to improve how financial products are governed and promoted.

The Government has decided that the Authority will be exempted from most of the financial market changes.

The rationale for this is that the Authority is already subject to strict governance and reporting requirements. Board members are appointed by the Minister of Finance and their duties are clearly defined in the GSF Act and the Crown Entities Act. The Authority must also provide comprehensive annual reports to the Minister of Finance, and comply with ministerial directions.

The Authority has already been exempted from the financial service providers' legislation, and the Government also proposes exempting the Authority from the pending governance and reporting reforms for financial securities.

Members can be assured that the Authority will continue governing GSF to the same high standard as currently.

Website

The Authority's website www.gsfa.govt.nz explains how the Authority operates and gives all members and interested parties immediate access to our latest quarterly investment results, as well as any changes the Authority makes to its policies, investment strategy or personnel.

Further Information

If you have any queries regarding your GSF membership, or would like a free copy of the annual report, please contact Datacom Employer Services, GSF Schemes Administration, PO Box 3614, Wellington, 6140, *Freephone 0800 654 731*.

Our Mission

The Authority's mission is to use best practice to manage the Fund and administer the GSF Schemes, in accordance with the 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.



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