



Chairman's Letter 2012

Dear Member

I am pleased to provide you with an update on the management of the Government Superannuation Fund (**GSF**) following the release of the annual reports of the Authority and GSF (or **the Fund**) for the year ended 30 June 2012.

Features of the 2012 year

- After two strong years, the return for the year to 30 June 2012 was disappointing.
- Despite a small surplus of \$25 million before tax there was an overall loss of \$17 million for the 2012 financial year after deduction of tax of \$42 million.
- Allocations to alternative strategies added value, however allocations to emerging markets and foreign currency did not.
- The continued high New Zealand (**NZ**) dollar impacted on returns from the Fund's unhedged foreign assets.
- Increased investment in insurance-linked assets with the addition of life settlements.
- Good progress has been made on the new business system for the administration of the GSF schemes. Construction is due to be completed in 2013 and planning for the final transition phase has commenced.

Tributes

Mark Verbiest resigned as a member of the Board at the end of May 2012.

Mr Verbiest contributed to both the Board's effectiveness and the Authority's achievements. The Board expresses its appreciation and thanks to Mr Verbiest for his contribution and wishes him well for the future.

David May retired as Deputy Chairman of the Board at the end of May 2012. Mr May was a member of the Government Superannuation Fund Establishment Board and was appointed Deputy Chairman when the Authority was established in 2001. During his almost 11 years of service, the Board benefitted from Mr May's wide experience in superannuation, his actuarial background and his valuable contribution to the current investment structure and management arrangements for GSF. The Board thanks Mr May for the significant contribution he has made.

Alan Langford retired as Chief Executive at the end of June 2012. Mr Langford had made an outstanding contribution as the Authority's Chief Executive since his appointment in 2001. He managed the business through several major restructurings and his wide knowledge of superannuation and investment markets has proved invaluable. The Board thanks Mr Langford and wishes him all the best for the future.

GSFA

Welcome

Simon Tyler was appointed Chief Executive of the Board from 1 July 2012. Mr Tyler was previously Head of Financial Markets at the Reserve Bank and, prior to that, held a number of senior positions at The National Bank. The Board looks forward to working with Mr Tyler in the future.

The Authority also welcomes Craig Ansley as a new member of the Board with effect from mid July 2012. Dr Ansley is an Adjunct Professor of Finance at the University of Auckland and a member of the Guardians of New Zealand Superannuation. Dr Ansley was founder of the New Zealand office of Russell Investment Group, and spent several years in senior roles in that organisation.

Thanks

The Board thanks the Minister of Finance and government officials for their support, and the Management team and staff for their high level of work and commitment to meeting the Authority's objectives.

I also thank my fellow Board members for their expertise and commitment during the year.

Yours sincerely



Keith B Taylor

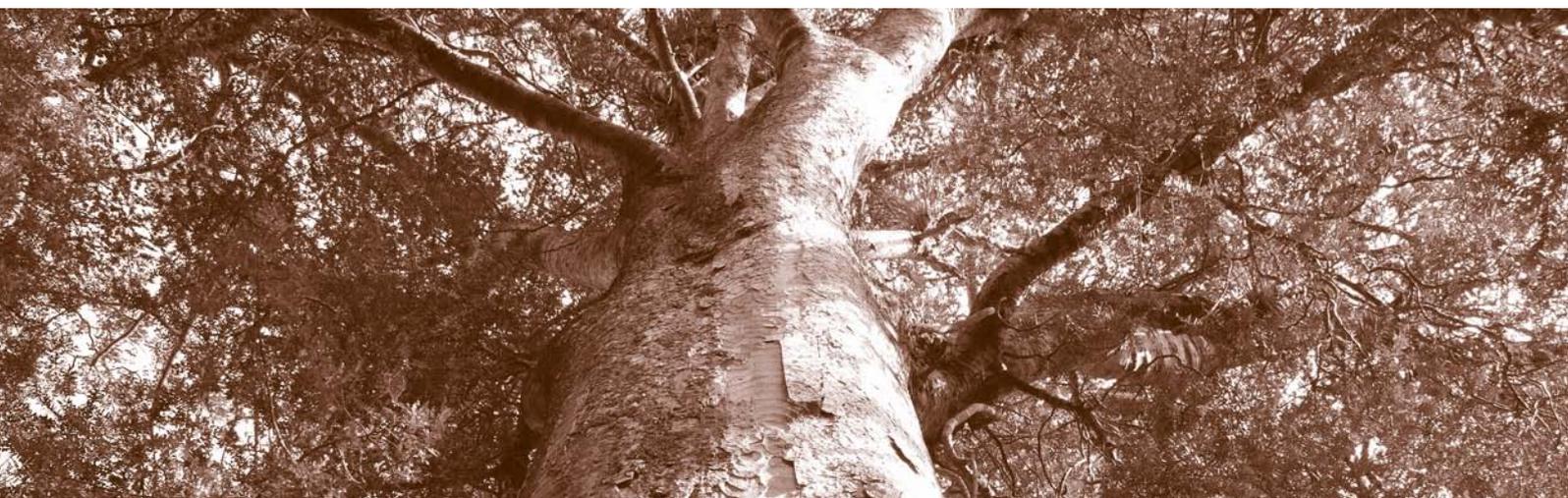
Chairman

Government Superannuation Fund Authority Board

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.



Investment Performance

The Fund's investment return for the year ended 30 June 2012 was disappointing after two strong years following the global financial crisis (GFC). Despite a small surplus of \$25 million before tax there was an overall loss of \$17 million for the 2012 financial year after deduction of tax of \$42 million. The return after tax of -0.5% compares with a return of 11.6% in 2011.

No significant changes were made to the Fund's investment strategy during the year. The Fund's investment in insurance-linked assets was increased in February 2012 with a modest investment in life settlements, a portfolio of life insurance policies on American lives selected according to strict criteria. Allocations to alternative strategies outside the Reference Portfolio contributed positively in the weak market environment but this was more than offset by allocations to emerging markets and foreign currency, which did not add value. External managers had a neutral overall impact on the Fund's investment return, earning sufficient added value to cover their fees.

The table below compares the Fund's investment returns after tax and expenses with the long term expected returns on NZ Government Stock (after tax) for periods ended 30 June 2012.

Returns to 30 June 2012 (%pa)	1 year	5 years	10 years
Fund return (after tax and expenses)	-0.5	-1.1	3.5
NZ Government Stock (after tax)	7.8	6.3	5.0
NZ Government Stock (after tax) plus 2.5%	10.3	8.8	7.5

The Fund return is behind its Investment Performance Measure (NZ Government Stock after tax, plus 2.5% measured over rolling 10 year periods) by 4.0% per annum. This is explained by the negative impact of historically poor global equity market returns over the last decade or more and, in contrast, the historically high returns from NZ Government Stock.

The five year annualised return includes the impact of the GFC on investment markets. The 10 year annualised return includes the impact of the GFC and the decline in equity markets in 2002/03.

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

Outlook

The bond market is anticipating an extended period of slow global economic growth and continued easy monetary conditions. Significant risk remains of a disorderly global deleveraging triggered by a breakup of the European Union in some form and a more severe global recession. Risk premiums are high in Europe as a result and this is depressing asset prices and currencies in that region.

Elsewhere, in North America and Asia, the risks emanating from the GFC have eased and while corporate profit margins are high, growth is sub-par and fragile owing to the high debt levels in developed countries. Increasingly, global growth and NZ's performance will be influenced by China and broader Asia where economic prospects are brightest.

Absolute returns are likely to be persistently low in this environment, however equities and other risky assets should provide positive premiums over government bonds over the next few years in contrast to the negative premiums of the recent past.

GSF Schemes

Administration

Datacom Employer Services Limited (**Datacom**) is the GSF scheme administrator and is responsible for the day to day administration of the GSF schemes. Datacom has approximately 30 staff dedicated to the GSF schemes and continues to perform well. For the 2012 financial year, 100% of all four weekly annuities were processed and paid on time.

New business system

Work continues on the development of a new and more sustainable business system for use in the administration of the GSF schemes. The detailed requirements for the project were completed in December 2010. The construction phase has been delayed and is now scheduled to be completed in 2013 (previously scheduled for around June 2012). Planning for transition from the old system to the new system is underway.

Actuary

The role of the Government Actuary was disestablished on 30 September 2011 and on 1 October 2011 Russell Employee Benefits Pty Limited (**Russell**) was appointed to provide actuarial services to the Authority. The Authority's current Actuary at Russell is Emma Brodie.

Statutory Review

The Act provides for a review to be conducted every five years of how effectively and efficiently the Authority is performing its functions under the Act. The first review was undertaken in 2006 and in March 2011 the Minister of Finance appointed JANA Investment Advisers (**JANA**) to undertake the second five yearly review. The review was tabled in Parliament in July 2011 and can be viewed at <http://treasury.govt.nz/releases/2011-07-28>.

In tabling the report the Minister stated that the reviewers found 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. JANA made some suggestions to improve the operation of the Authority and significant progress has been made on a number of these recommendations. These can be viewed at <http://www.gsfa.govt.nz/content/default.html>. Select Authority Reports / Statutory Review then download: *Stat Review 2012 08 24.pdf*.

Website

The Authority's website – www.gsfa.govt.nz – continues to be an important part of our communication strategy and contains comprehensive information on both the Authority and the Fund. It explains how the Authority operates and gives all stakeholders access to our quarterly investment results, as well as any changes the Authority makes to its policies, investment strategy and personnel.

www.gsfa.govt.nz

GSFA

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*.