

STATUTORY REVIEW 2021

WILLIS TOWERS WATSON RECOMMENDATIONS AND GSFA RESPONSES

Reference	Willis Towers Watson Recommendations	Government Superannuation Fund Authority (GSFA) Responses
Strategic Priorities		
SP 1	<p>Governance Budget</p> <p>We recommend GSFA evaluate its governance budget in light of the Fund’s complexity and take action to ensure these are fully aligned. We note here that GSFA has three broad options to ensure alignment between its governance budget and the Fund’s complexity. A mix of all three options is a possibility:</p> <ul style="list-style-type: none"> • Expand its governance budget by adding further resource and capabilities across both the Board and the investment team. • Expand its governance budget by making greater use of third-party providers (including the potential for appointing non-Board members to the Investment Committee). • Reduce the complexity of the Fund. 	<ul style="list-style-type: none"> • Agree • GSFA will consider options to improve alignment between governance budget and fund ‘complexity’. Note dependencies on References SP 3, KC 1, KC 2 and KC 5 below.
SP 2	<p>Beliefs & Comparative Advantages</p> <p>We recommend GSFA revisit its investment beliefs to:</p> <ul style="list-style-type: none"> • Provide a tighter link between Board-level beliefs, strategy adopted by GSFA and expected outcomes of acting on those beliefs. • Create a series of principles or sub-beliefs that capture how the executive gives effect to the Board’s beliefs. 	<ul style="list-style-type: none"> • Agree • Review of beliefs and creation of sub-beliefs is in progress. • Appropriate to review beliefs whenever there is significant change in GSFA Board composition in future.

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SP 3	<p>We recommend GSFA undertake an analysis to define and document in which areas, and why, it believes it has a comparative advantage in investment decision making.</p> <ul style="list-style-type: none"> We note that the analyses recommended here might impact on investment and governance model choices. 	<ul style="list-style-type: none"> Agree
SP 4	<p>Risk Management</p> <p>We recommend GSFA develops a risk appetite framework that:</p> <ul style="list-style-type: none"> Clarifies how total risk is defined (linked to Fund objectives) Encompasses a Risk Appetite Statement as a cornerstone of the risk budgeting process. Defines a total active risk (tracking error) range relative to the Reference Portfolio. Defines value add categories for spending the Fund’s active risk budget (aligned with beliefs and principles). Captures forward looking expectations for allocating the Fund’s active risk budget across categories and the associated expected return and information ratio. Expands consideration and articulation of risk into qualitative factors using a balanced scorecard to articulate the trades offs in spending the active risk budget. 	<ul style="list-style-type: none"> Agree Total risk is believed to be well defined in relation to NZ Government Bonds and total risk of the Reference Portfolio. Active risk could be better defined using ‘budget’ terminology however caution against confusion of ‘budget’ that may be seen as definitive with reasonable estimates of range of ‘expected outcomes’. Data used now can be expanded and explained more clearly.
Key Considerations		
KC 1	<p>Decision-making Frameworks</p> <p>We recommend GSFA capture its approaches to investment decision making in clear decision frameworks. These frameworks should cover at a minimum:</p> <ul style="list-style-type: none"> Risk management (as per previous recommendation). Dynamic asset allocation. Asset class portfolio construction. 	<ul style="list-style-type: none"> Agree

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	<ul style="list-style-type: none"> External manager selection and monitoring. Responsible investment, including integration of climate change considerations. <p>We note here that such frameworks will enhance the Board’s ability to exercise its oversight function and in doing so expand GSFA’s governance budget.</p>	
KC 2	<p>Board Education</p> <p>We recommend GSFA strengthen its Board induction processes and develop an ongoing education program.</p> <ul style="list-style-type: none"> We note here that such a program ideally has a mix of internally curated material, external expert guest speakers and attendance at relevant industry events. Furthermore, linking to the frameworks above will reinforce understanding of the investment approach. 	<ul style="list-style-type: none"> Agree Outside presentations and industry events provide useful context for GSFA Board members when discussing investment matters. Appropriate for induction and significant investment papers to reference decision-making frameworks discussed above. GSFA will review the induction program and continue current practice of considering presentation opportunities and industry events.
KC 3	<p>Portfolio Management</p> <p>We recommend GSFA deepen its portfolio management practices through:</p> <ul style="list-style-type: none"> Adoption of more disciplined risk/capital exposure processes creating understanding of exposures in the Fund at all times and having processes for shifting those exposures if they are not viewed as sufficiently rewarded. Greater focus on ‘hunting’ for new ideas and ongoing evaluation of previously disregarded opportunities whose relative attractiveness may have changed through time. Deeper evaluation of asset class sub-strategies and exposures with clear assessment criteria for aligning portfolio exposures with desired characteristics. 	<ul style="list-style-type: none"> Agree GSFA will review its portfolio management practices.

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	<ul style="list-style-type: none"> Greater use of scenario analysis as a technique to evaluate alternative possible outcomes. 	
KC 4	<p>Statement of Investment Policies, Standards and Procedures We recommend GSFA redraft its Statement of Investment Policies, Standards and Procedures (SIPSP) to:</p> <ul style="list-style-type: none"> Create greater clarity between policy, standard and procedures Incorporate a climate policy. Complete missing or incomplete elements related to liquidity; manager exposures; credit limits; leverage and securities lending. 	<ul style="list-style-type: none"> Agree GSFA will take into consideration as part of the current SIPSP review.
KC 5	<p>Investment Committee Role We recommend GSFA further strengthen the role of the Investment Committee by making it responsible for endorsing key investment recommendations that go to the Board.</p>	<ul style="list-style-type: none"> Agree. GSFA will review the terms of reference for the GSFA Board’s Investment Committee.
Suggestions		
S 1	<p>SIPSP We Suggest GSFA</p> <ul style="list-style-type: none"> Improve the documented links between the SIPSP and other organisational policies. Reinsert appropriate wording with respect to the Fund’s expected excess return over NZ Government Bonds. Use its Global Fixed Interest benchmark as the benchmark for Life Settlements. 	<ul style="list-style-type: none"> Agree in part. Redraft of SIPSP to include consideration of documented links between SIPSP and other organisational policies. Noted that whilst Global Fixed Interest is the funding source for Life Settlements, it is not an ideal benchmark as returns from Life Settlements are driven by life expectancy changes and Life Settlements market yield, neither of which is correlated to NZ Government Bond yields. GSFA will take into consideration as part of SIPSP review.

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S 2	<p>Investment Model We Suggest GSFA</p> <ul style="list-style-type: none"> • Consider a more formal manager review process with defined triggers for further consideration or action. • Adopt a regular process to screen Fund securities holdings to ensure unintended exposures are minimised. • Consider performance through a different lens portraying returns on active risk at a strategy level. 	<ul style="list-style-type: none"> • Agree to consider more formal manager review process including review triggers. • Agree it is appropriate to screen portfolios for unintended macro and factor exposures. • Agree it is appropriate to compare active returns with active risk at sub-portfolio level.
S 3	<p>Ethical Investment We Suggest GSFA</p> <ul style="list-style-type: none"> • Continue to develop its approach to ESG integration by deepening and broadening its approach over time to include: • Measuring and monitoring exposure to material ESG risks and opportunities on an ongoing basis. • Integrating material ESG factors into the entire investment process. • Engaging with existing investment managers to improve their approach to RI and being willing to direct capital away from external investment managers that lag best practice. • Consider whether ESG integration should be brought into the CFI resource sharing agreement to allow it to access additional resources. • Consider reviewing its approach to ensure consistency of voting with its views and to manage reputational risk. • Continue to develop its approach to stewardship, including developing formal voting and engagement policies and increasing disclosure and transparency by reporting stewardship activities to stakeholders. 	<ul style="list-style-type: none"> • Agree this is an area for ongoing development for GSFA. • GSFA considers environment, social and governance (ESG) factors from both investment and ethical perspectives. The ethical perspective is addressed in GSFA’s responsible investment policies. • General ESG investment risk is already captured by existing ‘quality’ metrics, whereas individual or particular ESG risks may be material for specific investment sectors and companies. • Active managers are responsible for managing investment risks and opportunities. • Managers with inadequate ESG approaches will rate less favourably. • GSFA works closely with other Crown Financial Institutions (CFIs) on unified approach to decarbonisation and broader ethical investment framework.

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	<ul style="list-style-type: none"> • Continue to develop its climate strategy to include assessment and management of both transition and physical risks across all asset classes. • Aligns its climate reporting approach with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. 	