B20

# Reports and Financial Statements

**for the year ended 30 June 2019**

GOVERNMENT SUPERANNUATION FUND AUTHORITY

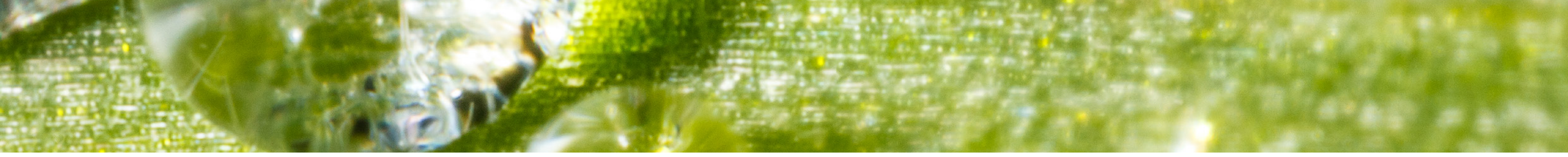
GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga

# Contents



*Reports presented to the House of Representatives pursuant to Section 150(3) of the Crown Entities Act 2004.*

GOVERNMENT SUPERANNUATION FUND AUTHORITY



# Chair's Report

On behalf of the Government Superannuation Fund Authority Board (the **Board**), I am pleased to present the annual reports on the activities of the Government Superannuation Fund Authority (the **Authority**) and the Government Superannuation Fund (**GSF** or the **Fund**) for the year ended 30 June 2019.

The Authority was established in October 2001 as a Crown entity by section 15A of the Government Superannuation Fund Act 1956 (**GSF Act**) and became an autonomous Crown entity under the Crown Entities Act 2004 (**Crown Entities Act**) in January 2005.

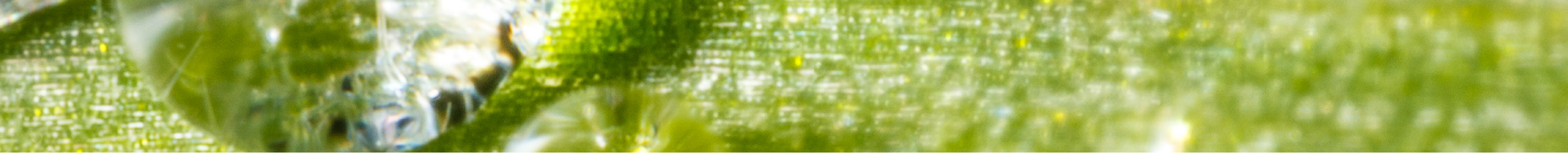
The Authority's mission is to use best practice to manage the Fund and administer the GSF Schemes, in accordance with the GSF Act, with the prime objectives of enabling:

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

The Authority is responsible for interpreting the provisions of the GSF Act relating to the GSF Schemes and exercising discretionary provisions. Management, appointed by the Board, carries out these functions under delegation from the Board.

## Features of the 2019 Year

- During the financial year to 30 June 2019, $893.4 million was paid out to members of the GSF Schemes. The business system, used to administer the GSF Schemes, performs well and brings further efficiency and stability to the schemes' administration area.
- Investment markets were volatile during the year. Equity markets fell in late 2018, amid recession fears and threats of trade wars, then rebounded in early 2019 as central banks, led by the US Federal Reserve and China, reverted to stimulus to avert a slump.
- The Fund takes a long term view when determining its investment strategy. Over the last 10 years the Fund investment return was 10.1% per annum net of investment management fees, 0.3% behind the Reference Portfolio and 4.4% ahead of NZ Government Bonds.
- For the financial year to 30 June 2019, the Fund returned 3.6% before tax and after investment management fees (compared to 7.7% for the Reference Portfolio) as alternative investments under-performed both bonds and equities.
- This year's under-performance pulled the Fund's average investment return for the last five years back to 8.6% per annum net of fees, 0.2% per annum behind the Reference Portfolio but 2.8% per annum above NZ Government Bonds.



## Investment Activity

The Fund's objective is to maximise the excess return above New Zealand (**NZ**) Government Bonds before New Zealand tax while limiting the chance of under-performing NZ Government Bonds over rolling ten year periods.

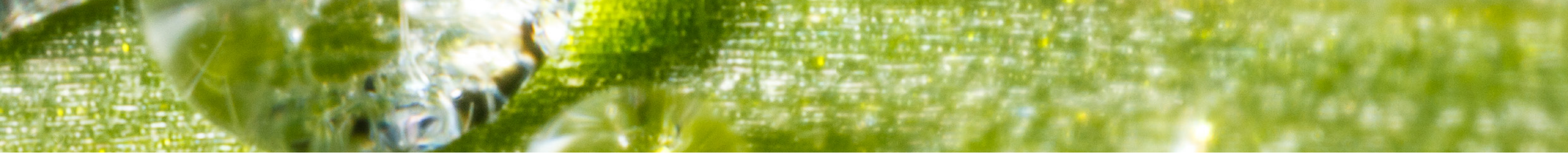
The Fund relies largely on equities to provide the excess return over NZ Government Bonds but is always looking for more efficient ways to capture alternative return sources. 90% of the Fund is invested internationally. Almost 20% is invested in alternative asset classes, such as insurance-linked assets, private equity and risk factors. These alternative sources of return diversify the Fund's risk, enabling higher total returns to be achieved at similar levels of risk. Alternatives, like bonds, are expected to perform better when equity markets perform badly. Active management is also used where there is a strong likelihood of added value net of any incremental costs. Nevertheless, global equity market risk remains by far the biggest investment risk to the Fund.

During the year the Fund continued to gradually increase its allocation to equities. This will result in a small increase in the risk and reward over a 10 year horizon. The Board approved increased exposure to alternative assets, diversifying return sources through a multi-factor, multi-asset class, equity market neutral 'style premium' fund. It is also increasing its commitments to global private equity over several years and implemented a long-short strategy with one of its existing global equities managers to capture an increased return from their skill at picking stocks.

There has been considerable attention given to incorporating environmental, social and governance factors (**ESG**) into the investment programmes of funds around the world. The Fund relies on third party investment firms to manage its assets and these managers take account of such factors when they are material to expected returns and risks. The Authority also collaborates with other Crown Financial Institutions (**CFIs**), notably the Guardians of New Zealand Superannuation (**NZ Super**) and the Accident Compensation Corporation (**ACC**). As well as discussing common investment issues, the Authority shares the services of a global engagement service company to co-ordinate engagements with global companies that have serious issues around damage to the environment, human rights abuse and bribery and corruption. Investments in certain securities are excluded where the issuer is considered to be acting contrary to NZ law, international agreements, significant government policies, or breaches prescribed standards of behaviour.

## 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. It explains how the Authority operates and gives all stakeholders access to our annual investment results, as well as any changes the Authority makes to its policies, Fund investment strategy and personnel.



## The Board

Cecilia Tarrant retired from the Board at the end of June 2019. Cecilia was initially appointed to the Board in August 2011, became the Deputy Chair in July 2013 and was appointed Chair in May 2017. Cecilia made a considerable contribution to the Authority during her tenure and I would like to thank Cecilia for all her work.

Angela Foulkes joined the Board 1 November 2018. Angela has extensive public and private sector consultancy experience and has served on a range of government sector advisory and regulatory bodies, including on state sector standards, educational qualifications and government sector structure.

The Board has two permanent sub committees - an Investment Committee and an Audit and Risk Review Committee. The Investment Committee forms an important part of the investment strategy as it works closely with Management to provide comfort to the Board that due process is documented and implemented by Management prior to bringing a recommendation to the Board. The Board members on the Investment Committee are Alison O'Connell (Chair) and Murray Brown. The Audit and Risk Review Committee's purpose is to assist the Authority in fulfilling its responsibilities for managing and administering the Fund and the Schemes pursuant to the Government Superannuation Fund Act 1956. This committee is chaired by Shelley Cave and the other Board members on this subcommittee are Michelle van Gaalen, Alison O'Connell and Angela Foulkes.

## Conclusion

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.

**Anne Blackburn**
*Chair*
*Government Superannuation Fund Authority Board*

04 September 2019

GOVERNMENT
SUPERANNUATION FUND
AUTHORITY

# Investment Commentary

## Investment Strategy

The Authority is required to invest the Fund on a prudent, commercial basis. In so doing, its investment objective is to maximise returns without undue risk to the Fund as a whole, while managing and administering the Fund in a manner consistent with best practice portfolio management.

The Authority defines this objective as being to maximise the Fund's excess return relative to NZ Government Bonds (before NZ tax), while limiting the chance of under-performing NZ Government Bonds over rolling 10 year periods. Several risk measures are considered in determining the Fund's risk level.

In addition to the Fund's long term return and risk measures, the Authority established a notional Reference Portfolio in 2010 to define and monitor the Fund's relative risk and return performance over shorter, interim periods. The Reference Portfolio is a simple, globally diversified asset allocation that is expected to meet the long term investment objective by investing passively in liquid public markets at low cost.

The Fund relies largely on equities to provide the excess return over NZ Government bond returns but is always looking for more efficient ways to capture alternative return sources. Almost 20% of the Fund is invested in alternative assets, such as catastrophe insurance, life settlements, private equity and alternative style premia that is expected to provide an independent source of returns. Insurance-based investments have provided diversification of bond investments.

Global equities, bonds and most of the alternative assets are managed actively as we believe there are additional returns from skilled management. All active investment decisions are benchmarked against the Reference Portfolio to assess whether they add value in terms of higher returns for equivalent risk, net of costs. These decisions include the addition of asset classes that diversify the Fund's sources of return as well as skill-based active management strategies.

90% of the Fund is invested internationally to avoid concentration risk in NZ assets. Our hedging strategy limits the foreign currency exposure to 20% on average.

## Asset Allocation and Reference Portfolio

The Authority reviewed its Reference Portfolio last year. From 1 July 2018 the Reference Portfolio's allocation to global equities has increased gradually to 65% and the allocation to global bonds has reduced to 25%. NZ equities represents the other 10%. This shift will continue through the current year until the overall allocation is 80% global equities/20% global bonds, increasing the Fund's expected return and risk. The Board is satisfied the overall risk level remains acceptable. In particular, the probability of under-performing bonds by more than 10% over a 10 year period is estimated at less than 20%.

Table 1 sets out the Fund's asset allocation, as at 30 June 2019 and 2018, compared with the Reference Portfolio.

**Table 1: Asset Allocation**

| Asset Class | Investment Assets at 30 June 2019 $m | Investment Assets at 30 June 2019 % | Investment Assets at 30 June 2018 $m | Investment Assets at 30 June 2018 % | Reference Portfolio % |
|---|---|---|---|---|---|
| Global bonds | **412** | **9.1** | 615 | 13.6 | 25 |
| Global equities | **2,536** | **56.0** | 2,609 | 57.6 | 65 |
| Global private equity | **287** | **6.3** | 220 | 4.9 | – |
| NZ equities | **225** | **5.0** | 312 | 6.9 | 10 |
| NZ private equity | **147** | **3.2** | 114 | 2.5 | – |
| Commodity futures | **–** | – | 81 | 1.8 | – |
| Catastrophe insurance | **247** | **5.5** | 255 | 5.7 | – |
| Life settlements | **128** | **2.8** | 153 | 3.4 | – |
| Style Premia | **420** | **9.3** | 231 | 5.1 | – |
| Currency overlay | **43** | **0.9** | (80) | (1.8) | – |
| DAA overlay* | **85** | **1.9** | – | – | – |
| **Total** | **4,530** | **100.0** | **4,510** | **100.0** | **100** |
| Foreign Currency Exposure | | 20.0 | | 20.0 | 20 |

**The DAA overlay includes Commodity futures.*

*The numbers in the table may differ from the numbers in the Statement of Net Assets for the Fund (on page 30) because of different disclosure requirements for financial reporting purposes.*

*All table figures are rounded therefore may not add exactly.*

## Investment Returns

Investment markets were volatile in 2018/2019 punctuated by sharp declines in equity markets in December 2018 and a recovery through to the June 2019 year-end. Global equities returned a modest 6.4% for the financial year as a whole and global bonds a surprisingly strong 8.6%, helping the Reference Portfolio to a solid 7.7% return.

The Fund return on investments for the year ended 30 June 2019 was 3.6% (before tax and after investment fees), under-performing the Reference Portfolio by 4.1%. The excess return over five years is now -0.2% per annum.

The main driver of the subpar performance was the Fund's exposure to alternative assets, i.e. assets other than global equities and bonds that make up the bulk of the Reference Portfolio. 18% of the Fund is invested in alternative risk premia and insurance-linked securities and these had large negative returns. Alternative risk premia suffered from poor returns from the 'value' factor in large cap global equity markets without any offsetting gain from other factors that are normally useful, such as quality, momentum and yield. Major catastrophe claims in 2017 and 2018 hurt the Fund's catastrophe insurance portfolio and increasing life expectancy estimates required a write-down of part of our life settlements portfolio. The purpose of these investments is to provide similar returns to equities on average while performing well when equities do badly. Despite a bad year, the Board is satisfied these alternative assets remain appropriate to the Fund's objectives.

The Fund's external equities managers, both global and domestic, had a poor year too, subtracting a further 0.9% from the Reference Portfolio.

Table 2 compares the Fund's investment return before tax and after investment fees against the Reference Portfolio and NZ Government Bonds over periods ended 30 June 2019.

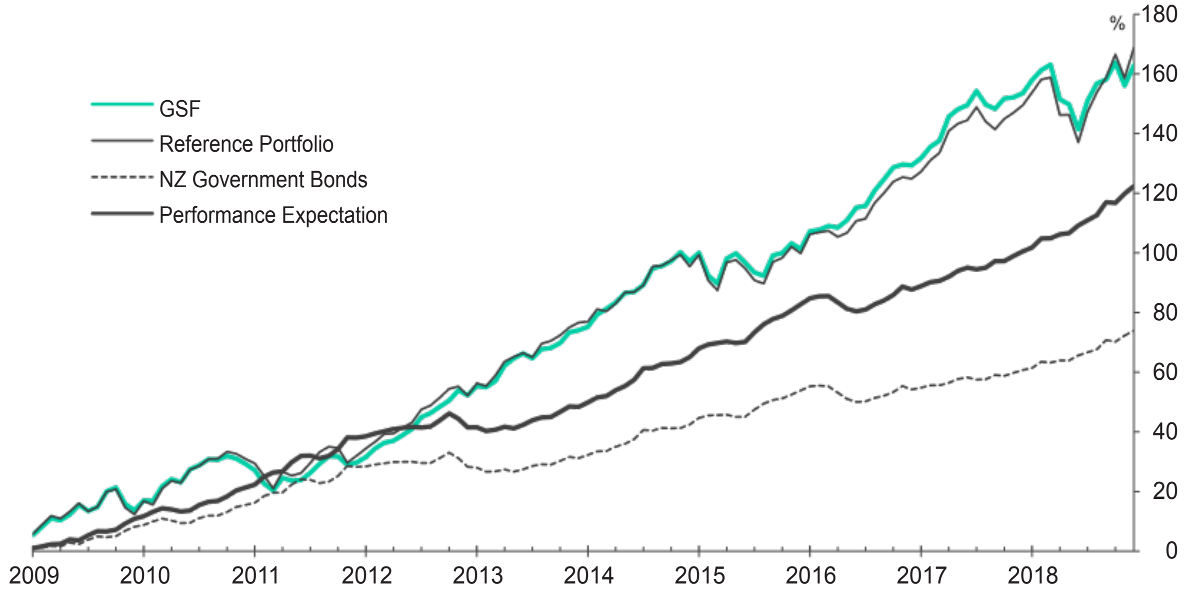
### Table 2: Total Fund Return Summary

| Return to 30 June 2019 | 1 Year | 3 Years | 5 Years | 10 Years | SI |
|---|---|---|---|---|---|
| Fund Net of Investment Fees | **3.6** | 9.3 | 8.6 | 10.1 | 7.2 |
| Reference Portfolio | **7.7** | 10.4 | 8.8 | 10.4 | 7.3 |
| NZ Government Bonds | **8.2** | 4.2 | 5.8 | 5.7 | 6.0 |

*Return comprises gross of fees returns prior to 30 June 2009 and net of investment fees thereafter.*

The following chart shows cumulative returns of the Fund and its benchmarks over the last 10 years.

### 10 year Cumulative Return as at 30 June 2019



## Returns by Asset Class

Table 3 shows the investment returns by major asset class compared to the relevant asset class benchmark. (All returns annualised in NZ dollars (**NZD**) before NZ tax and after investment fees.)

**Table 3: Returns by Asset Class**

| Asset Class | 1 Year to June 2019 | | 3 Years | | 5 Years | |
|---|---|---|---|---|---|---|
| | Actual | Benchmark | Actual | Benchmark | Actual | Benchmark |
| Total fund[1] | **3.6** | 7.72 | 9.3 | 10.4 | 8.6 | 8.8 |
| Global bonds | **8.3** | 8.6 | 4.4 | 3.3 | 5.4 | 5.3 |
| Global equities | **6.1** | 6.4 | 13.6 | 13.7 | 12.3 | 11.8 |
| NZ equities | **14.0** | 18.4 | 15.8 | 16.2 | 16.5 | 16.6 |
| Catastrophe insurance | **(3.1)** | (0.7) | (0.1) | 3.0 | 5.7 | 7.9 |
| Life settlements | **(23.2)** | (21.7) | (4.2) | (7.0) | 0.9 | 0.1 |
| Style Premia | **(10.6)** | 3.1 | N/A | N/A | N/A | N/A |
| Currency Overlay | **(0.7)** | (1.0) | (1.2) | (1.5) | (3.3) | (4.0) |

[1] *The total Fund and global bond returns are hedged to NZD. Global equities, catastrophe insurance and life settlements are the unhedged returns.*

[2] *The benchmark for the total Fund is the Reference Portfolio.*

[3] *The DAA overlay return was not included as the overlay commenced on 1 August 2018.*

## Outlook

Global economic growth is expected to decelerate over the next 12 months to a below trend pace, with risks skewed to the downside. Protectionist policies are already weighing on global trade volumes and the uncertainty it brings is holding back business investment. Businesses are meeting demand through hiring which, unlike capital expenditure, can be unwound quickly. This is supporting the labour market and incomes which, in-turn, is helping consumer confidence. In recognition of the slowdown and downside risks, and with inflation pressure easing, central banks are expected to cut rates and in some regions, turn again to other monetary policy tools.

Modest growth and inflation, along with easier monetary policy, is typically positive for both equities and bonds. However, a quarter of the global investment grade bond universe now come with negative yields which will limit their returns.

Yields have also moved lower on global equities, as share prices have risen faster than company earnings over the last year, and this points to lower total Fund returns in the future.

The expected return differential between global equities and bonds is still above the long-term average, which indicates global equity investors are still being compensated for higher risk. Very low bond yields, not inexpensive equity markets, is the reason for this.

The NZ share market has had another good year and equity prices are extended relative to fundamentals. In contrast, the NZD is a little below fair value as suggested by the long-term real exchange rate, but it should continue to act as a safety valve (i.e. decline) if global risks continue to rise.

## Responsible Investment

The Act requires the Authority to manage and administer the Fund in a manner consistent with avoiding prejudice to NZ's reputation as a responsible member of the world community. The Authority must also have an ethical investment policy. The Authority addresses these matters through its Responsible Investment Policies (**RI**), which cover the exercise of voting rights with respect to shares owned by the Authority and consideration of governance, environmental and social issues relating to its investments.

In terms of its RI Policies, the Authority excludes direct investment in securities issued by companies involved in the manufacture of tobacco and illegal weapons. These activities are inconsistent with Government policy or international conventions to which NZ is a party.

The Authority has joined with other CFIs in hiring a global engagement firm to co-ordinate engagement on our behalf with global companies that have significant RI issues. The Authority has participated in engagements with several companies with other CFIs and, in some cases, with global peer funds linked through the Principles for Responsible Investment (**PRI**). Examples include palm oil producers' environmental damage and child labour issues, social media companies' failure to block objectionable material and mining companies' unsafe management of tailings dams. If companies materially breach our RI standards and engagement is unlikely to change their behaviour the Board will consider excluding them from our portfolio and has done so. The Authority has also encouraged its investment managers to consider the PRI and ensure that governance, environmental and social risks are analysed adequately as part of their investment processes.

The Authority invests in a number of collective investment vehicles (**CIVs**). These are a practical and cost effective way to get exposure to some markets and managers. The Authority cannot influence directly the securities held by the CIVs, or their individual voting decisions. A CIV's ability to comply with the RI Policies is considered as part of the investment evaluation and, if an investment is made in the CIV, the manager of the CIV is advised of the RI Policies and associated decisions and encouraged to reflect them in their own policies.

The Authority and other CFIs have similar RI obligations and all are signatories to the PRI. The CFIs work together to implement their RI Policies using consistent information and research gathered initially by the RI unit of NZ Super.

The Authority monitors its external managers' use of environmental social and governance factors (**ESG**) in their investment processes. Managers consider these factors to some degree in selecting investments, usually to assess risk and in some cases to enhance expected returns. Managers are also increasing their focus on the sustainability of businesses in the face of efforts to mitigate climate change risk. The long horizon for climate change risks to impact businesses and the wide range of potential impacts and public policy responses across countries makes it impossible to predict investment impacts with confidence. Nevertheless, the risk is real and data quality is improving making it imperative for investors to begin to address the potential outcomes when evaluating alternative investments.

# Schemes Commentary

## Schemes administration

Datacom Connect Limited (**Datacom**) continues as the administrator of the GSF Schemes and has met the performance standards that have applied since 1 July 2009. These performance standards are specific in terms of required response times. Management works closely with Datacom and continues to encourage best practice in schemes administration.

The GSF business system has enabled increased efficiency and provides higher reliability. Annually GSF pays approximately $880 million to members and Datacom responds to around 10,000 telephone calls. Datacom corresponds with all members annually and combined with inquiries this results in around 100,000 pieces of correspondence.

## Privacy and Security

The Board is very aware of the need to respect members' privacy. We are required to hold personal information about members for the purposes of ongoing management and administration of the GSF Schemes. Personal information is data about an identifiable individual or information that could be used to identify a member, such as a name and contact details.

We are bound by, and adhere to, the privacy provisions set out in the Privacy Act 1993.

With this in mind, please be aware Datacom will never send a generic email asking a member for personal information (for example, bank account number or date of birth) or ask a member to provide their bank account details over the telephone.

The Board and Datacom will never:

- ask for banking PINS or passwords;
- send you a link to a GSF website login page;
- ask you to download any software onto a computer;
- ask you to give us remote access to a computer.

If at any time a member has any concerns about requests received, please call Datacom on 0800 654 731.

# *Statement of Governance and Accountability*

The Authority was established in October 2001 as a Crown entity under section 15A of the GSF Act and became an autonomous Crown entity under the Crown Entities Act in January 2005. The business of the Authority is to manage the assets and administer the GSF Schemes and the Fund in accordance with the GSF Act.

Section 15G of the GSF Act specifies the Board is responsible for the business of the Authority.

## Government Superannuation Fund Authority Board – as at 04 September 2019

The Minister of Finance has appointed the following six members to the Board:

**Anne Blackburn** (Chair) Appointed 1 July 2018 and became Chair of GSFA on 1 July 2019. Ms Blackburn is a director of TSB Bank, Fidelity Life Limited, Fisher Funds Management Limited and Warren and Mahoney Limited. Ms Blackburn is also a Director of Annuitas Management Limited. Ms Blackburn has a background in banking, governance and strategic advice, and returned to NZ in the mid 1990's after 15 years working in international investment banks in New York and London.

**Michelle van Gaalen** (Deputy Chair) Appointed 1 November 2012. Ms van Gaalen is the Managing Director of Carglass (NZ) Limited and is a Director of Annuitas Management Limited. She has previously held various executive roles including Director of Strategy and Business Performance for the Bank of New Zealand Limited. She is a Chartered Member of the Institute of Directors and also a Fellow of the Australian CPA.

**Shelley Cave** (Chair of Audit and Risk Review Committee) Appointed 1 July 2014. Ms Cave is a Director of Delegat Group Limited and a co-founder and Director of The FoodPath NZ Limited. She was formerly a partner of the law firm Simpson Grierson specialising in capital markets transactions.

**Alison O'Connell** (Chair of the Investment Committee). Appointed 1 May 2017. Dr O'Connell is a Board member of the Earthquake Commission and the Christchurch Art Gallery Foundation. She is a Fellow of the New Zealand Society of Actuaries and the Institute of Actuaries and a Chartered Member of the Institute of Directors. Dr O'Connell formerly held executive roles at the Pensions Policy Institute, Swiss Re and McKinsey.

**Murray Brown** Appointed 1 July 2018. Mr Brown is a board member of Yachting NZ and a Chartered Member of the Institute of Directors. He previously held senior management positions at Fisher Funds Management and First NZ Capital.

**Angela Foulkes** Appointed 1 November 2018. Ms Foulkes has extensive public and private sector consultancy experience and has served on a range of government sector advisory and regulatory bodies, including on state sector standards, educational qualifications and government sector structure.

## Remuneration of Board Members

Remuneration of Board members is in accordance with the rates set by the Minister of Finance.

## Responsibilities and Operations of the Board

The Board is responsible for all decisions relating to the business of the Authority.

The Board has two permanent committees with specific responsibilities for Audit and Risk Review and Investments.

The Chair is an ex officio member of both committees.

As required by the GSF Act, the Board does not delegate the following powers:

- the power of delegation;
- the power to grant a power of attorney; and
- the power to appoint the schemes administration manager, investment managers, other service providers and the custodian.

## Auditor

The Auditor-General is the auditor of the Authority. The Auditor-General has appointed Michael Wilkes of Deloitte Limited to act on his behalf.

## Our People

The Authority and the Board of Trustees of the National Provident Fund (**NPF**) have formed a joint venture company, Annuitas Management Limited (**Annuitas**). Each organisation has entered into a management services agreement (**MSA**) with Annuitas.

The main function of Annuitas is to provide staff (**Management**) who act in managerial and secretarial roles on behalf of the Authority and NPF. The MSA between Annuitas and the Authority contains delegations of authority to enable Management to carry out the day to day management of the Authority's investment, custody and schemes management arrangements. In the case of schemes management, the delegation includes interpretation of the provisions of the GSF Schemes and exercise of discretionary powers in accordance with the Provisions, Policies and Procedures of the GSF.

Annuitas has 14 staff and strives to be a good employer. It is committed to offering equal employment opportunities (**EEO**) to prospective and existing staff.

Annuitas has a Health, Safety and Wellness Policy and regular meetings are held with all staff to help achieve its aim of providing a healthy and safe workplace.

Workplace flexibility and investment in professional development are core to its employment offering and, whilst none of the staff have serious disabilities, Annuitas strives to be a good equal employment opportunity employer.

## Diversity of Staff

| | | | |
|---|---|---|---|
| **Ethnicity** | New Zealand/ Other European<br>13 | Asian<br>1 | Māori<br>0 |
| **Sex** | Male<br>6 | Female<br>8 | |
| **Age** | Under 35<br>3 | 35-55<br>5 | Over 55<br>6 |

Staff participated in a range of educational development programmes during the year.

The activities of Annuitas compared with seven key elements (as per Human Rights Commission) of being a good employer are summarised in the table below.

| Elements | Annuitas Activity |
|---|---|
| ***Leadership, accountability and culture*** | • Alignment between strategic plan objectives, individual objectives and performance measures. |
| ***Recruitment, selection and induction*** | • Robust recruitment and selection process.<br>• Orientation and induction for all staff. |
| ***Employee development, promotion and exit*** | • Professional development opportunities identified and sourced.<br>• Any vacancies advertised internally.<br>• Exit interview process. |
| ***Flexibility and work design*** | • IT systems facilitate working from home.<br>• Flexible Working Arrangements Policy. |
| ***Remuneration, recognition and conditions*** | • Transparent, equitable and gender-neutral job evaluation practices.<br>• Remuneration benchmarked against third-party NZ data.<br>• Discretionary performance incentive scheme. |
| ***Harassment and bullying prevention*** | • Acceptable Conduct Policy for Employees and Contractors signed annually by all employees and available at all times.<br>• Relevant other policies available at all times. |
| ***Safe and healthy environment*** | • Robust Health, Safety and Wellness Policy.<br>• Strong focus on employee health, safety and well-being. |

All Annuitas policies are regularly reviewed and/or updated.

The Management team is:

- Simon Tyler — Chief Executive
- Fiona Morgan — Chief Financial Officer
- Philippa Drury — General Manager, Schemes
- Paul Bevin — General Manager, Investments

## Indemnity

The Authority has:

- provided indemnities to each Board member under Deeds of Indemnity whereby the Authority agreed to indemnify each Board member (subject to certain exceptions) for certain costs and liabilities in respect of certain acts and omissions (being acts and omissions in good faith and in performance or intended performance of the Authority's functions) to the maximum extent permitted by the Crown Entities Act; and
- entered into Deeds of Indemnity with members of Management, who exercise delegations on behalf of the Board in terms of the MSA, whereby it agreed to indemnify the members of Management (subject to certain exceptions) for certain costs and liabilities in respect of certain acts and omissions (being acts and omissions in good faith and in performance or intended performance of the Authority's functions) to the maximum extent permitted by the Crown Entities Act.

The indemnities provided by the Authority to Board members and the members of Management do not protect the Board members, or the members of Management, against any liability, claim or proceeding of any kind for any dishonesty or fraud or anything else that either:

- as a matter of public policy cannot be indemnified at law; or
- is criminal liability that the Authority has determined, in its absolute discretion, should be excluded from the indemnity.

The Authority has determined that all criminal liability, other than strict liability offences, should be excluded from the scope of the indemnities. Broadly speaking, strict liability offences are those for which no intent needs to be established.

## Insurance

During the financial year, the Authority continued directors' and officers' insurance cover for Board members and members of Management in respect of potential liabilities and costs incurred through acts and omissions made in the performance, or intended performance, of the functions of the Authority. Insurance is not provided for an act or omission that is in bad faith.

The Authority also continued company reimbursement insurance cover in respect of any claims made by Board members, or members of Management, under the indemnities described above.

The scope of the directors' and officers' insurance cover and the company reimbursement insurance cover is consistent with the limitations imposed by the Crown Entities Act.

# *Statement of Performance*

The Authority is responsible for the overall management of the Fund. The two outputs are the management of the assets of the Fund and the management of the GSF Schemes.

This Statement of Performance measures the Authority's progress against objectives and measures set out in the Authority's 2017-2021 Statement of Intent and 2018 Statement of Performance Expectations.

## Investment Management

| Activity | Measure | Expected Outcome | Actual Result | | | | |
|---|---|---|---|---|---|---|---|
| | | 5 year average | 1 year | 3 years | 5 years | 10 years | |
| **Maximising Return Without Undue Risk** | Fund return before tax after fees %pa | 6.3 | 3.6 | 9.3 | 8.6 | 10.0 | Achieved |
| | Reference Portfolio return before tax %pa | 5.3 | 7.7 | 10.4 | 8.8 | 10.4 | N/A |
| | NZ Government bond return before tax %pa | 2.0 | 8.2 | 4.2 | 5.8 | 5.7 | N/A |
| | Value added versus Reference Portfolio | 1.0% | -4.1% | -1.1% | -0.2% | N/A | Not Achieved |
| | Value added versus NZ Government Bonds | 4.3% | -4.6% | 5.1% | 2.8% | 4.3% | Achieved |
| | Risk adjusted return (Sharpe Ratio) | 0.46 | n/a | 0.8 | 0.5 | 0.7 | Achieved |
| | Probability of under-performing NZ Government Bonds over 10 years by more than 10% | 7-13% | 7-12% | <25% | <25% | <25% | Achieved |
| | Volatility | 10% | n/a | 6.1% | 6.1% | 6.4% | Achieved |
| | Value at risk $m | 460 | 447 | | | | N/A |
| | Beta to global equities | 0.7 | 0.6 | 0.5 | 0.5 | 0.5 | Achieved |

| Activity | Measure | Expected Outcome | Actual Result | | | | |
|---|---|---|---|---|---|---|---|
| | | 5 year average | 1 year | 3 years | 5 years | 10 years | |
| **Best Practice** | Statutory Review | Positive review | The last statutory review was completed in 2016 and concluded, among other things, the Authority is effectively and efficiently performing its designated functions. | | | | Achieved |
| | SIPSP | Independent review | The SIPSP is reviewed annually by an independent adviser. | | | | Achieved |
| | Investment costs | Costs competitive with peer funds measured like for like in terms of size and risk | The Fund's performance and costs are benchmarked annually against global peer funds. In calendar 2018 costs were in line with global peers of similar size and risk profile. Over the 5 years to December 2018 the Fund's performance was ahead of peers in terms of value added while costs of 88bp were 10bp above peers on account of larger allocations to private equity. Manager fees also compare favourably against NZ peers. | | | | Achieved |
| | Custodian performance | Custodian meets agreed service standards continuously | The custodian is monitored against KPIs contained in the Service Level Agreement and service issues are addressed with the custodian quarterly. | | | | Achieved |
| | Investment manager compliance | Managers remain within agreed risk limits continuously | There were no material breaches of investment management agreements by external managers that required further action. | | | | Achieved |

<table>
<tr><th rowspan="2">Activity</th><th rowspan="2">Measure</th><th>Expected Outcome</th><th colspan="5">Actual Result</th></tr>
<tr><th>5 year average</th><th>1 year</th><th>3 years</th><th>5 years</th><th>10 years</th><th></th></tr>
<tr><td rowspan="5">Avoiding Prejudice</td><td>Exclusions policy</td><td>Exclusion of certain investments</td><td colspan="4">The list of excluded investments was maintained in collaboration with other CFIs and implemented with external managers. Commingled fund investments were also advised of exclusions.</td><td>Achieved</td></tr>
<tr><td>Engagement</td><td>Successful engagements with entities that breach the Authority's standards</td><td colspan="4">The Authority collaborated with international peer funds through PRI, BMO and NZ Super networks in several engagements. Subjects included palm oil, mining tailings and social media's failure to block objectionable material. Progress was made on all engagements.</td><td>Achieved</td></tr>
<tr><td>Rating in PRI annual assessment survey</td><td>High comparative ratings versus peer funds</td><td colspan="4">The Authority received A ratings in the 2018 annual PRI survey assessment for application of its principles for responsible investment. The A ratings covered all modules reported including Strategy and Governance, Listed Equities and Fixed Income.</td><td>Achieved</td></tr>
<tr><td>Voting</td><td>Active voting by external managers</td><td colspan="4">The Authority's voting records of contracted managers are published every six months and identify where managers voted against company management.</td><td>Achieved</td></tr>
<tr><td>Reputational risk</td><td>No adverse effects on reputation arising from portfolio investments</td><td colspan="4">This is measured by the absence of negative publicity relating to Responsible Investment issues. No negative correspondence received.</td><td>Achieved</td></tr>
</table>

## Schemes

| Activity | Measure | Expected Outcome | Actual Result |
|---|---|---|---|
| **Schemes** | | | |
| **Pay entitlements** | 100% of all annuities paid on time and all contributions banked on receipt and allocated as soon as verified as being correct. | 100% | Achieved |
| **Correspondence** | All routine correspondence responded to within 5 working days. | 100% | Achieved |
| **Systems and Technology** | | | |
| **Business system** | No major loss or corruption of data or functionality. | No major loss | Achieved |
| **Business system** | Functionality remains relevant to requirements. | 100% functionality | Achieved |
| **Business system** | Ability to access required data. | 100% access | Achieved |
| **Business continuity plan** | Having appropriate business continuity plans in place. | Plan in place and tested | Achieved |
| **Legislation** | | | |
| **Provision of information** | No requests being received for missing or incomplete information. | No requests received | Achieved |
| **Provision of information** | Timeframes met for requests for information. | Timeframes met | Achieved |
| **Governance** | | | |
| **Survey** | Achieving consistently good (60% and over) satisfaction scores in the major aspects of the biennial survey of members and employers. | Satisfaction met | Achieved |

GOVERNMENT SUPERANNUATION FUND

# *Authority's Report*

On behalf of the Government Superannuation Fund Authority (the **Authority**), I am pleased to present this report on the Government Superannuation Fund (**GSF** or the **Fund**) for the year ended 30 June 2019. The report is made in accordance with section 93B of the Government Superannuation Fund Act 1956 (**GSF Act**).

The Fund dates back to 1948 when it was established to provide a way for state sector employees to save for their retirement. Contributors make regular payments to the Fund and in return, on retirement, receive a defined level of income. Employers, who are not funded directly by the Government, pay contributions as set by the Actuary, at the amount necessary to fund the balance of their employees' entitlements. The Government meets the balance of the costs of the employees' entitlements as they become payable. The Fund was largely closed to new members in 1992.

In 2001, the Authority was established under the Act to manage the Fund's assets and administer the GSF Schemes.

The Act provides for interest to be paid into or out of the Fund in respect of members' contributions or benefits. In respect of interest charged by the Fund, the rate is equivalent to the gross return on the Fund for the year. For the year ended 30 June 2019, the gross return was 4.4% before tax and expenses (2018: 11.2% before tax and expenses).

This annual report includes information on membership, and other matters required by the GSF Act. Commentary on the investment performance of the Fund starts on page 6. Information on the Authority can be found commencing on page 3.

## Membership

Although the GSF Schemes were closed to new members in July 1992, and the Pacific Island sub-schemes closed on 22 October 1995, the GSF Schemes will continue to have a very substantial membership for many years.

Details of the membership of the GSF Schemes are set out on pages 24-25.

**Anne Blackburn**
*Chair*
*Government Superannuation Fund Authority Board*

04 September 2019

# Regulatory Statement

In accordance with the Financial Markets Conduct Act 2013 the Authority states that, to the best of its knowledge and belief, for the financial year ended 30 June 2019:

- On the basis of evidence available, all contributions required to be made to the Fund, in accordance with the GSF Act, have been made or accrued.
- All benefits required to be paid from the Fund under the GSF Act have been paid.
- Due to the partially funded nature of the GSF Schemes, the market value of assets fell short of the accrued benefit liability of the Fund by $8,049 million (2018: $8,169 million). The deficiency is covered by Section 95 of the GSF Act, which requires the Minister of Finance to appropriate funds from public money to meet the annual deficiency in payments from the Fund.

**Anne Blackburn**
*Chair*
*Government Superannuation Fund Authority Board*

04 September 2019

# Membership Commentary

## Movement in contributors during the past five years

| Year ended 30 June | Total | Change Contributors | % Change |
|---|---|---|---|
| 2015 | 9,767 | (813) | (7.68) |
| 2016 | 9,060 | (707) | (7.24) |
| 2017 | 8,356 | (704) | (7.77) |
| 2018 | 7,743 | (613) | (7.34) |
| **2019** | **7,136** | **(607)** | **(7.84)** |

## Number of contributors, by scheme

| GSF Scheme | 2019 | % of Total | 2018 |
|---|---|---|---|
| General Scheme | **6,801** | 95.31 | 7,376 |
| Armed Forces | **122** | 1.71 | 123 |
| Police | **188** | 2.63 | 213 |
| Prisons Service | **24** | 0.34 | 29 |
| Judges and Solicitor-General | **–** | 0.00 | 1 |
| Parliamentary | **1** | 0.01 | 1 |
| **Total contributors at end of year** | **7,136** | **100.00** | **7,743** |

## Movement in the number of contributors during the year

| | 2019 | 2018 |
|---|---|---|
| Contributors at beginning of year | **7,743** | 8,356 |
| Cessation of employment before retirement | **(20)** | (35) |
| Death before retirement | **(22)** | (19) |
| Retirements | **(557)** | (553) |
| Transfer to other schemes | **(6)** | (5) |
| Withdrawals | **(2)** | (1) |
| **Total contributors at end of year** | **7,136** | **7,743** |

## Movement in the number of annuitants during the past five years

| Year ended 30 June | Total Annuitants | Change | % Change |
|---|---|---|---|
| 2015 | 45,967 | (392) | (0.85) |
| 2016 | 45,635 | (332) | (0.72) |
| 2017 | 45,279 | (356) | (0.78) |
| 2018 | 44,834 | (445) | (0.98) |
| **2019** | **44,417** | **(417)** | **(0.93)** |

## Movement in number of annuitants during the year:

| | 2019 | 2018 |
|---|---|---|
| Annuitants at beginning of year | **44,834** | 45,279 |
| New retiring allowances | **557** | 553 |
| New allowances to spouses | **632** | 724 |
| Deferred pensions now in payment | **416** | 376 |
| Discontinued allowances | **(2,022)** | (2,098) |
| **Total annuitants at end of year** | **44,417** | **44,834** |

There were 3,323 deferred pensions at 30 June 2019 (2018: 3,739).

## Movement in total number of members during the past five years:

| Year ended 30 June | Total Contributors | Total Annuitants | Total Deferred Pensions | Total Members | Decrease During Year |
|---|---|---|---|---|---|
| 2015 | 9,767 | 45,967 | 4,827 | 60,561 | (1,500) |
| 2016 | 9,060 | 45,635 | 4,508 | 59,203 | (1,358) |
| 2017 | 8,356 | 45,279 | 4,115 | 57,750 | (1,453) |
| 2018 | 7,743 | 44,834 | 3,739 | 56,316 | (1,434) |
| **2019** | **7,136** | **44,417** | **3,323** | **54,876** | **(1,440)** |

## From 1996 the number of annuitants has exceeded the number of contributors. The present ratios are:

| | 2019 | % | 2018 | % |
|---|---|---|---|---|
| Contributors | **7,136** | 14 | 7,743 | 16 |
| Annuitants | **44,417** | 86 | 44,834 | 84 |
| | **51,553** | **100** | **52,577** | **100** |

## Granting a charge over contributions

In the year to 30 June 2019, 8 charges (2018: 16) were registered by the Fund in favour of charge holders as security over individual contributor's contributions.

# Financial Statements

# *Statement of Responsibility*

The Financial Statements of the Fund for the year ended 30 June 2019 have been prepared in accordance with Section 93 of the GSF Act.

The Authority is responsible for the preparation of the Financial Statements and the judgements made in the process of producing those statements.

The Authority confirms that:

- internal control systems have been established and maintained during the year to assure reasonable reliability and integrity of these Financial Statements; and
- the investment policies, standards, and procedures for the Fund, commencing on page 87, have been complied with.

In our opinion, the attached Financial Statements present a true and fair view of the net assets, as at 30 June 2019, and the changes in net assets and the cash flows of the Fund, for the year ended 30 June 2019.

**Anne Blackburn**
*Chair*
*Government Superannuation Fund Authority Board*

**Simon R Tyler**
*Chief Executive*

4 September 2019

# Statement of Changes in Net Assets

## For the year ended 30 June 2019

| | Note | 2019 $000 Actual | 2019 $000 (unaudited) Forecast | 2018 $000 Actual |
|---|---|---|---|---|
| **Change in assets from investing activities** | | | | |
| Interest, dividends and other income | 1 | **115,424** | 104,133 | 120,255 |
| Changes in fair value of investment assets through profit or loss | 2 | **78,685** | 208,266 | 349,444 |
| | | **194,109** | 312,399 | 469,699 |
| **Operating activities** | | | | |
| **Operating expenses** | 3 | | | |
| Funding for the Authority | 14 | **(44,612)** | (49,320) | (45,039) |
| **Surplus before tax and membership activities** | | **149,497** | 263,079 | 424,660 |
| Income tax (expense) | 4 | **(32,703)** | (61,939) | (3,405) |
| **Surplus after tax and before membership activities** | | **116,794** | 201,140 | 421,255 |
| **Membership activities** | | | | |
| **Contributions** | | | | |
| Government | 5 | **701,738** | 714,000 | 717,715 |
| Members | | **22,651** | 19,000 | 26,372 |
| Other employers | | **15,702** | 16,000 | 17,455 |
| Total contributions | | **740,091** | 749,000 | 761,542 |
| **Benefits and refunds paid** | 6 | **(893,437)** | (911,000) | (881,539) |
| **Net membership activities** | | **(153,346)** | (162,000) | (119,997) |
| Net (decrease)/increase in net assets | | **(36,552)** | 39,140 | 301,258 |
| Opening net assets available to pay benefits | | **4,572,438** | 4,576,138 | 4,271,180 |
| **Net assets available to pay benefits** | | **4,535,886** | 4,615,278 | 4,572,438 |

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# *Statement of Net Assets*

## As at 30 June 2019

| | Note | 2019<br>$000<br><br>Actual | 2019<br>$000<br>(unaudited)<br>Forecast | 2018<br>$000<br><br>Actual |
|---|---|---|---|---|
| **Current assets held at fair value through profit or loss** | | | | |
| Derivative assets | 13.5 | **61,764** | 93,500 | 18,836 |
| **Current assets at amortised cost** | | | | |
| Cash and cash equivalents | | **212,926** | 180,000 | 253,011 |
| Trade and other receivables | 7 | **105,366** | 69,594 | 68,729 |
| **Total current assets at amortised cost** | | **318,292** | 249,594 | 321,740 |
| **Other current assets** | | | | |
| **Income tax receivable** | 4 | **–** | – | 25,368 |
| **Total current assets** | | **380,056** | 343,094 | 365,944 |
| **Non-current assets held at fair value through profit or loss** | | | | |
| **Investments** | | | | |
| Commodities | | **–** | 88,723 | 81,458 |
| Derivative assets | 13.5 | **8,182** | 16,500 | 5,153 |
| Equities – NZ | | **345,055** | 467,486 | 353,361 |
| Equities - International | | **2,421,110** | 2,200,472 | 2,449,427 |
| Global bonds | | **419,462** | 496,506 | 599,293 |
| Global private equity | | **287,403** | 307,857 | 220,227 |
| Insurance-linked assets | | **374,710** | 475,100 | 405,610 |
| Style Premia Fund | | **420,377** | 277,623 | 230,630 |
| Property – NZ | | **1,442** | 5,000 | 3,349 |
| Other investments | | **66,203** | 51,450 | 60,424 |
| **Total investments** | 13.5 | **4,343,944** | 4,386,717 | 4,408,932 |
| **Other non-current assets** | | | | |
| Deferred tax asset | 4 | **–** | – | 1,513 |
| Business System | 8 | **18,878** | 17,365 | 20,592 |
| **Total non-current assets** | | **4,362,822** | 17,365 | 4,431,037 |
| **Total assets** | | **4,742,878** | 4,747,176 | 4,796,981 |

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Statement of Net Assets *(continued)*

## As at 30 June 2019

| | Note | 2019 $000 Actual | 2019 $000 (unaudited) Forecast | 2018 $000 Actual |
|---|---|---|---|---|
| **Less liabilities** | | | | |
| **Current liabilities held at fair value through profit or loss** | | | | |
| Derivative liabilities | 13.8 | **23,340** | 17,500 | 95,870 |
| Current liabilities at amortised cost | | | | |
| Trade and other payables | 9 | **152,048** | 85,898 | 120,040 |
| Other current liabilities | | | | |
| Income tax payable | 4 | **22,748** | 20,500 | – |
| **Total current liabilities** | | **198,136** | 123,898 | 215,910 |
| **Non-current liabilities held at fair value through profit or loss** | | | | |
| Derivative liabilities | 13.8 | **3,962** | 3,000 | 8,633 |
| **Other non-current Liabilities** | | | | |
| Deferred Tax Liability | 4 | **4,894** | 5,000 | – |
| **Total non-current liabilities** | | **8,856** | 8,000 | 8,633 |
| **Total liabilities** | | **206,992** | 131,898 | 224,543 |
| **Net assets available to pay benefits** | | **4,535,886** | 4,615,278 | 4,572,438 |
| **Promised retirement benefits** | | | | |
| Gross liability for promised retirement benefits | 12 | **12,585,000** | 12,443,000 | 12,742,000 |
| Deficit | | **8,049,114** | 7,827,722 | 8,169,562 |
| **Net assets available to pay benefits** | | **4,535,886** | 4,615,278 | 4,572,438 |

The Financial Statements were approved by the Authority Board on 4 September 2019.

**Anne Blackburn**
*Chair*
*Government Superannuation Fund Authority Board*

**Shelley Cave**
*Chair*
*Audit & Risk Review Committee*
*Government Superannuation Fund Authority Board*

4 September 2019

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Statement of Cash Flows

## For the year ended 30 June 2019

| | 2019<br>$000<br><br>Actual | 2019<br>$000<br>(unaudited)<br>Forecast | 2018<br>$000<br><br>Actual |
|---|---|---|---|
| **Cash flows from operating activities**[1] | | | |
| Cash was provided from: | | | |
| Government contributions - members | **660,879** | 669,848 | 677,288 |
| Government contributions - expenses | **37,976** | 44,388 | 41,837 |
| Members' contributions | **23,129** | 19,025 | 23,884 |
| Other employers' contributions - members | **11,915** | 12,083 | 13,435 |
| Other employers' contributions - expenses | **4,200** | 3,917 | 4,355 |
| Interest and dividends | **116,018** | 105,260 | 120,242 |
| Income tax | **21,819** | – | – |
| Cash was disbursed to: | | | |
| Benefit payments | **(893,793)** | (910,975) | (879,695) |
| Income tax | **–** | (40,470) | (57,126) |
| Operating expenses | **(43,034)** | (49,602) | (42,821) |
| **Net cash outflows from operating activities** | **(60,891)** | (146,526) | (98,601) |
| Cash flows from investing activities[2] | | | |
| Cash was provided from: | | | |
| Maturities and sales of investment assets | **5,029,485** | 3,212,333 | 3,862,378 |
| Cash was disbursed to: | | | |
| Purchase of investment assets | **(5,008,252)** | (3,075,777) | (3,702,246) |
| Business System | **(427)** | – | (368) |
| **Net cash inflows from investing activities** | **20,806** | 136,556 | 159,764 |
| Net (decrease)/increase in cash held | **(40,085)** | (9,970) | 61,163 |
| Opening cash and cash equivalents | **253,011** | 189,970 | 191,848 |
| **Closing cash and cash equivalents**[3] | **212,926** | 180,000 | 253,011 |

[1] *Operating activities include any activities that are the result of normal business activities (excluding investing activities).*

[2] *Investing activities comprise acquisition and disposal of investments. Investments include securities not falling within the definition of cash.*

[3] *Cash and cash equivalents comprise cash balances held with banks in NZ and overseas. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, are subject to insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments. Only items that have a maturity of three months or less, from balance date, are classified as cash and cash equivalents.*

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Statement of Changes in Deficit

## For the year ended 30 June 2019

| | 2019 $000 Actual | 2019 $000 (unaudited) Forecast | 2018 $000 Actual |
|---|---|---|---|
| **Opening deficit at the beginning of the year** | **(8,169,562)** | (8,118,862) | (8,662,820) |
| Change in liabilities amount | **157,000** | 252,000 | 192,000 |
| Change in Net Assets | **(36,552)** | 39,140 | 301,258 |
| **Closing deficit at the end of the year** | **(8,049,114)** | (7,827,722) | (8,169,562) |

*Note – Deficit*

- *The estimated actuarial present value of Promised Retirement Benefits (Gross Liability) – refer note 12 - is the present value of the expected payments by the Fund to existing and past members, attributable to the services rendered. The present value was calculated by the Authority's Actuary, as at 30 June 2019, under NZ IAS 26, using a net discount rate.*
- *The Deficit is the value of the Gross Liability less the value of the Net Assets of the Fund.*
- *There is no requirement on the Crown to fully fund the Deficit in relation to the GSF Schemes. The Crown meets its obligation to pay members' entitlements on an as required basis.*
- *Reliance is placed by the Authority on the provisions of section 95 of the Act which requires the Minister to appropriate funds from public money to ensure that sufficient funds are available, or will be available, to pay entitlements as they fall due.*

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Reconciliation of Net Changes in Net Assets to Net Operating Cash Flows

## For the year ended 30 June 2019

| | 2019<br>$000 | 2018<br>$000 |
|---|---|---|
| **Net (decrease)/increase in net assets** | **(36,552)** | 301,258 |
| **Non–cash items** | | |
| Deferred tax payable/(receivable) | **6,407** | (1,220) |
| Amortisation of the Business System | **2,347** | 2,578 |
| Total non–cash items | **8,754** | 1,358 |
| **Movements in working capital items** | | |
| Benefits payable | **273** | (163) |
| Government contributions received in advance - benefits | **(262)** | 108 |
| Income tax payable | **22,748** | (27,134) |
| Income tax receivable | **25,368** | (25,368) |
| Investment expense payable | **(13)** | (909) |
| Investment payables | **32,323** | 38,649 |
| Investment receivables | **(33,670)** | (2,569) |
| Other employers' contributions received in advance – benefits | **–** | (1,834) |
| Other employers' contributions received in advance – expenses | **19** | – |
| Receivables and prepayments | **(2,967)** | 3,458 |
| Trade and other payables | **(332)** | (245) |
| Total movement in working capital items | **43,487** | (16,007) |
| **Changes in items classified as investing activities** | | |
| Accrued interest portion of bonds | **965** | 131 |
| Accrued payments for Business System | **(207)** | 183 |
| Change in fair value of investment assets | **(78,685)** | (349,444) |
| Investment settlement receivables | **33,670** | 2,569 |
| Investment settlement payables | **(32,323)** | (38,649) |
| Total movement in investing activities | **(76,580)** | (385,210) |
| **Net cash out flows from operating activities** | **(60,891)** | (98,601) |

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Judges and Solicitor-General Superannuation

## Statement of Changes in Net Assets

### For the year ended 30 June 2019

| | 2019 $000 | 2018 $000 |
|---|---|---|
| **Income from operations*** | | |
| Government contributions | **15,103** | 15,423 |
| Total contributions | **15,103** | 15,423 |
| **Expenditure*** | | |
| Benefits paid: | | |
| Retirements | **11,628** | 11,984 |
| Allowances capitalised | **488** | 583 |
| Spouses and children | **2,987** | 2,856 |
| Total Benefits paid | **15,103** | 15,423 |
| **Net changes in net assets** | **–** | – |

** These figures are incorporated in the Government Superannuation Fund Statement of Changes in Net Assets.*

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Parliamentary Superannuation

## Statement of Changes in Net Assets

### For the year ended 30 June 2019

| | 2019<br>$000 | 2018<br>$000 |
|---|---|---|
| **Income from operations*** | | |
| Government contributions | **4,506** | 4,948 |
| Members' contributions | **13** | 32 |
| Total contributions | **4,519** | 4,980 |
| **Expenditure*** | | |
| Benefits paid: | | |
| Retirements | **3,756** | 3,714 |
| Allowances capitalised | **–** | 508 |
| Spouses and children | **763** | 758 |
| Total Benefits paid | **4,519** | 4,980 |
| Net changes in net assets | **–** | – |

* *These figures are incorporated in the Government Superannuation Fund Statement of Changes in Net Assets.*

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Notes to the Financial Statements

**For the year ended 30 June 2019**

## 1. Interest, dividends and other Income

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Commodities | **158** | – |
| Equities – International | **49,522** | 53,307 |
| Equities – NZ | **17,114** | 8,802 |
| Global bonds | **14,292** | 18,774 |
| Global private equity | **9,063** | 8,317 |
| Insurance linked assets | **438** | 6,262 |
| Property – NZ | **–** | 4,353 |
| Short term and call deposits | **433** | 382 |
| Other income | **24,404** | 20,058 |
| **Total interest, dividends and other income** | **115,424** | 120,255 |

## 2. Changes in fair values of investment assets through profit or loss*

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Commodities | **(6,827)** | 6,631 |
| Equities – International | **97,028** | 272,847 |
| Equities – NZ | **37,322** | 50,007 |
| Global bonds | **21,146** | (10,781) |
| Global private equity | **14,664** | 33,157 |
| Insurance-linked assets (net) | **(51,742)** | (9,314) |
| Style Premia Fund | **(37,495)** | 2,798 |
| Property – NZ | **3,982** | 998 |
| Short term investments | **607** | 3,101 |
| **Total changes in fair values of investment assets through profit or loss** | **78,685** | 349,444 |

* *Includes changes resulting from hedging (where applicable).*

## 3. Operating expenses

In terms of section 15E (1) of the GSF Act, the administrative expenses of the Authority, including investment management and custody expenses, are reimbursed by the Fund. Both the Government and other employers reimburse the Fund under section 95 of the GSF Act for the Authority's expenses. In the reporting period, as certified by the Actuary, the Government contributed 91% (2018: 90%) of the Authority's administrative expenses reimbursed by the Fund. Other employers contributed the balance of 9% (2018: 10%).

## 4. Income tax

| | 2019 $000 | 2018 $000 |
|---|---|---|
| **Reconciliation to statement of changes in net assets** | | |
| Surplus before tax and membership activities | **149,497** | 424,660 |
| Add imputation credits | **2,099** | 3,127 |
| Net taxable income | **151,596** | 427,787 |
| Tax expense at 28% | **42,447** | 119,780 |
| Tax effect: | | |
| Non-taxable (gains)/non-deductible losses on equity investments | **(52,887)** | (158,171) |
| Foreign Investment Fund income | **45,016** | 42,208 |
| Prior period adjustment | **231** | (106) |
| Imputation credits | **(2,099)** | (3,127) |
| Withholding tax credits | **(5)** | 2,821 |
| **Income tax expense** | **32,703** | 3,405 |
| **Income tax expense comprises:** | | |
| Current tax | **30,213** | 4,731 |
| Deferred tax | **2,259** | (1,220) |
| Prior period adjustment | **231** | (106) |
| **Income tax expense** | **32,703** | 3,405 |
| **Movement in deferred taxation** | | |
| Opening balance | **1,513** | 293 |
| Prior period adjustment | **(231)** | – |
| Transfer tax losses to current tax | **(3,917)** | – |
| Current year movement | **(2,259)** | 1,220 |
| **Deferred tax (liability)*/asset** | **(4,894)** | 1,513 |
| **Movement in income tax payable** | | |
| Opening balance | **25,368** | (27,134) |
| Current year movement | **(30,213)** | (4,731) |
| Transfer tax losses to current tax | **3,917** | – |
| Tax (refunds)/payments | **(24,711)** | 53,000 |
| Withholding Tax Credits/Other | **2,891** | 4,232 |
| **Income tax (payable)/receivable** | **(22,748)** | 25,368 |

** The 2019 deferred tax liability of $4.9 million relates to the Business System.*

## 5. Government and employer contributions

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Government service superannuation contributions | **641,532** | 656,809 |
| Government Superannuation Fund Authority expenses | **40,597** | 40,535 |
| Judges and Solicitor-General superannuation contributions | **15,103** | 15,423 |
| Parliamentary superannuation contributions | **4,506** | 4,948 |
| **Total Government contributions** | **701,738** | 717,715 |

### *Funding arrangements*

There is no requirement on the Government to fully fund the GSF Schemes. The basis of funding to meet benefits is partly from contributors' contributions, and the surplus after-tax, the balance being the contributions from the Government and non-departmental employers. Reliance is placed on the provisions in the GSF Act for the Government to ensure that sufficient funds are available, or will be available, to pay benefits as they fall due.

| GSF Schemes | Member Contribution % of salary | Employer Contribution for year ended 30 June 2019 % of salary |
|---|---|---|
| General Scheme: | | |
| - Non-funding employers* | 6.5 | 13.4 |
| - Funding except Islands** | 6.5 | between 13.8 and 17.4 |
| - Islands | 6.5 | 16.1 |
| Armed Forces | 7.6 | 15.4 |
| Police | 7.5 | 16.8 |
| Prisons Service | 8.5 | Nil |

* *Not receipted by the Fund, paid to the Crown.*

** *As the employer contribution rate is subject to age and gender of contributors, it is different from one employer to another.*

The employer contribution rates were reviewed as part of the statutory actuarial valuation of the Fund as at 30 June 2018. As a result some changes to employer contribution rates were implemented with effect from 1 July 2019 (see Note 11).

## 6. Benefits and refunds paid

| | 2019 $000 | 2018 $000 |
|---|---|---|
| **Benefits:** | | |
| Allowances capitalised | **20,155** | 21,214 |
| Pension entitlements | **737,934** | 726,690 |
| Spouses and children | **130,181** | 128,372 |
| **Refunds:** | | |
| Cessation of membership | **2,180** | 2,050 |
| Death | **1,630** | 1,126 |
| Transfers to other schemes | **1,357** | 2,087 |
| **Total benefits and refunds paid** | **893,437** | 881,539 |

## 7. Trade and other receivables

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Government contributions - expenses | **5,056** | 2,435 |
| Interest and dividends | **6,538** | 5,959 |
| Investment settlements receivable | **92,695** | 59,025 |
| Members' contributions | **54** | 21 |
| Other employers' contributions – benefits | **49** | 17 |
| Other employers' contributions – expenses | **–** | 166 |
| Past service contributions | **627** | 725 |
| Pension entitlements | **347** | 332 |
| Prepaid benefits | **–** | 49 |
| **Total trade and other receivables** | **105,366** | 68,729 |

The Authority does not believe there are any financial assets past due at balance date and, therefore, there is no impairment.

## 8. Business System

The Business System is used for the administration of the GSF Schemes. It supports the core business functions of the GSF Schemes including contributions management, benefit calculation and payment, scheme administration, financial accounting and schemes reporting.

The Authority went live with a new Business System in November 2016. Amortisation costs of $2.347 million are included within the operating expenses of the Fund (2018: $2.578 million). At year end the Business System was reviewed against NZ IAS 36: Impairment of Assets which resulted in no provision for impairment being made (2018: Nil).

## 9. Trade and other payables

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Benefits payable | **510** | 237 |
| Government contributions in advance – benefits | **347** | 609 |
| Government Superannuation Fund Authority | **3,927** | 4,259 |
| Investment expenses | **27** | 40 |
| Investment settlements payable | **147,218** | 114,895 |
| Other employers' contributions – expenses | **19** | – |
| **Total trade and other payables** | **152,048** | 120,040 |

## 10. Actuarial valuations of the Fund

### *Statutory actuarial valuation*

Section 94 of the GSF Act requires that the Authority must obtain a report from an actuary that examines the financial position of the Fund as at dates determined by the Minister of Finance, being dates that are no more than three years apart. On 22 August 1999, the Minister directed annual valuations be carried out.

The latest published statutory actuarial valuation was undertaken by the Authority's actuary, Matthew Burgess, (FNZSA, FIAA), Towers Watson Australia Pty Ltd as at 30 June 2018. The report was tabled in Parliament on 4 April 2019. More information on the results of the valuation is provided in Note 11.

### *NZ International Accounting Standards NZ IAS 26 actuarial valuation*

An actuarial valuation of the Fund was undertaken by the Authority's Actuary, Matthew Burgess, (FNZSA, FIAA), Towers Watson Australia Ltd as at 30 June 2019 to determine the value of the promised retirement benefits, in accordance with NZ IAS 26, for the Financial Statements of the Fund – refer Note 12.

## 11. Statutory actuarial valuation as at 30 June 2018

Details of the statutory actuarial valuation, as at 30 June 2018, are included for information only. The statutory actuarial valuation is used to determine the employer subsidy rates and to apportion entitlements between the Fund and Government.

Significant assumptions, used in the statutory valuation were:

| | |
|---|---|
| Discount rate/Return on Assets | 5.0% per annum (2017:5.0%) |
| Consumer Price Index/Pension Increase (long term) | 2.0% per annum (2017:2.0%) |
| Salary growth | 2.5% per annum (2017:2.5%) |

Rates of mortality, morbidity and withdrawal are based on scheme experience, with that experience being used to adjust standard published tables where available.

The results of the 30 June 2018 statutory actuarial valuation are:

| | **2018 $ million** | **2017 $ million** |
|---|---|---|
| **Past service liabilities** | | |
| Armed Forces contributors | 4 | 4 |
| General Scheme contributors (excluding Islands) | 1,841 | 1,992 |
| General Scheme contributors (Islands only) | 64 | 64 |
| Police contributors | 177 | 193 |
| Prisons Service contributors | 11 | 12 |
| Judges and Solicitor-General, and Parliamentary | 4 | 14 |
| Pensioners | 9,920 | 9,860 |
| Deferred pensioners | 749 | 796 |
| Total past service liabilities* | 12,769 | 12,934 |
| Less value of Fund assets | 4,572 | 4,271 |
| Unfunded past service liability* | 8,197 | 8,663 |

* *Total may not add up due to rounding.*

## 11. Statistory actuarial valuation as at 30 June 2018 *(continued)*

Vested benefits are calculated as the amount payable in the event that all contributors ceased membership as at the valuation date. The vested benefit values are shown in the following table, where contributors include the inactive members. The ratio of vested benefits to past service liabilities is also shown.

| **Schemes/Group** | **2017 As a percentage of past service liability** | **2018 $ million** | **2017 $ million** |
|---|---|---|---|
| **Vested Benefits** | | | |
| Contributors: | | | |
| Armed Forces | 100% | 4 | 4 |
| General Scheme-excluding Islands | 108% | 1,987 | 2,127 |
| General Scheme-Islands | 105% | 67 | 65 |
| Police | 98% | 173 | 186 |
| Prisons Service | 100% | 11 | 12 |
| Judges and Solicitor-General, and Parliamentary | 100% | 4 | 14 |
| **Total Contributors** | 107% | **2,246** | **2,409** |
| Pensioners: | | | |
| Pensioners | 100% | 9,920 | 9,860 |
| Deferred pensioners | 100% | 749 | 796 |
| **Total Pensioners** | 100% | **10,669** | **10,656** |
| **Grand total** | 101% | **12,915** | **13,064** |
| Less net assets | | 4,572 | 4,271 |
| Shortfall | | 8,343 | 8,793 |

*The above figures are rounded and so may not appear to add exactly*

The Fund has been closed to new entrants since 1992. Members with 10 or more years' service are generally eligible to take an immediate or deferred retiring allowance on leaving the Fund. As a result, almost all members in the Fund can take either an immediate pension or a deferred retiring allowance.

The total value of these pensions for all members, as at the valuation date, is the vested benefits.

Members will retire at dates later than 30 June 2018. The pension they receive at their actual retirement date can be split into that part accrued at the valuation date and that which will accrue after the valuation date. The net asset value of the Fund was used as the actuarial value of the assets.

The valuation revealed the Fund was in deficit at the date of the valuation. The benefits payable from the Fund are underwritten by the Government. The Actuary recommended that from 1 July 2019, the Government pays 73.8% of each benefit paid (2017 valuation, from 1 July 2018: 74.6%).

Employer contribution rates effective 1 July 2019, including employer superannuation contribution tax (ESCT) at 33% (if applicable), are as follows:

## 11. Statutory actuarial valuation as at 30 June 2018 *(continued)*

- for funding employers (employers of those contributors who are paid from money that is not public money) the employer contribution rate has been calculated on an employer by employer basis, based solely on the members employed by each employer;
- for employers that are the Public Services of the Cook Islands, Niue or Tokelau, the employer contribution rate is certified as 16.1% of contributor salaries; and
- for funding employers other than the Public Services of the Cook Islands, Niue or Tokelau, contributions are calculated on an employer by employer basis only on the contributors employed by that employer. The resulting employer rates are then smoothed to reduce the immediate impact of a change in valuation methodology. Contribution rates include ESCT and an allowance for expenses. A sample of average contribution rates at selected ages, before smoothing, is set out in the follow table by age and gender:

| Age | Males | Females |
|---|---|---|
| 50 | 16.2% | 16.3% |
| 55 | 17.0% | 17.1% |
| 57 | 17.2% | 17.3% |
| 59 | 17.4% | 17.5% |
| 61 | 17.5% | 17.6% |
| 63 | 17.4% | 17.5% |
| 65 | 16.8% | 16.9% |
| 67 | 16.7% | 16.8% |

For non-funding employers (employers of those contributors who are paid from money that is public money) the employer contribution rate has been determined under a notional funding approach. The employer contribution rates recommended in the statutory actuarial valuation report as at 30 June 2018, effective from 1 July 2019 and after smoothing, are as follows:

- for the Armed Forces Scheme: a rate of 15.1% of contributor salaries;
- for the General Scheme: a rate of 14.4% of contributor salaries;
- for the Police Scheme: a rate of 17.2% of contributor salaries;
- for the Prisons Service Scheme: a rate of 0% of contributor salaries;
- for the Judges and Solicitor-General Scheme: an amount equal to the benefits payable; and
- for the Parliamentary Scheme: an amount equal to the benefits payable.

## 12. Gross liability for promised retirement benefits as at 30 June 2019

The Actuary has valued the promised retirement benefits in accordance with NZ IAS 26, as at 30 June 2019, for the purposes of the Fund's Financial Statements.

Significant assumptions, used in the valuation, were:

| | |
|---|---|
| Discount rate/Return on Assets | 5.0% per annum |
| Consumer Price Index/Pension Increase (long term) | 2.0% per annum |
| Salary growth | 2.5% per annum |

## 12. Gross liability for promised retirement benefits as at 30 June 2019 *(continued)*

| Movement in promised retirement/past service benefit liability | 2019 $ million | 2018 $ million |
|---|---|---|
| Opening gross promised retirement/past service benefit liability | **12,742** | 12,934 |
| Movements in liability | | |
| Expected changes | **(260)** | (239) |
| Experience (gains)/losses | **62** | 20 |
| Assumption changes: | | |
| Change in discount rate, Consumer Price Index and salary assumption | **16** | 27 |
| Change in demographic assumption (including mortality improvement) | **25** | – |
| Closing gross promised retirement/past service benefit liability | **12,585** | 12,742 |

### *Vested benefits – 30 June 2019*

Vested benefits are calculated as the amount payable in the event that all contributors ceased membership as at the valuation date. The vested benefit values, as at 30 June 2019, are shown in the following table, where contributors include the inactive members.

| Vested benefits | 2019 $ million | 2018 $ million |
|---|---|---|
| Contributors | **2,028** | 2,211 |
| Pensioners: | | |
| Current pensioners | **10,015** | 9,920 |
| Deferred pensioners | **691** | 749 |
| Total pensioners | **10,706** | 10,669 |
| Total vested benefits | **12,734** | 12,879 |
| Less net assets | **4,536** | 4,572 |
| Shortfall* | **8,198** | 8,307 |

** Total may not add up due to rounding.*

## 13. Financial Instruments

### 13.1 Management of financial Instruments

The investments of the Fund are managed on behalf of the Authority by specialist investment managers, which are required to invest the assets allocated for management in accordance with the terms of written investment management agreements. The Authority has determined that the appointment of these managers is appropriate for the Fund and is in accordance with the Authority's SIPSP.

JP Morgan Chase acts as the global custodian on behalf of the Authority. They provide services including safekeeping of assets, settlement of trades, collection of investment income, and accounting for investment transactions.

## 13. Financial instruments *(continued)*

### 13.2 Significant accounting policies

Details of the significant accounting policies and methods adopted are disclosed in Note 18.10 to the financial statements. These include the criteria for recognition, the basis of measurement, and the basis on which revenues and expenses are recognised in respect of each class of financial asset and financial liability. All policies have been applied consistently to all periods with the exception of NZ IFRS 9: Financial Instruments (NZ IFRS 9).

### 13.3 Capital risk management

The investment strategy, Reference Portfolio and Target Portfolio are reviewed regularly by the Authority, in conjunction with its advisers (see page 7). The Authority reviews the cash requirements and funding of the GSF Schemes, each month, in the context of maintaining the Target Portfolio, and redeems or invests funds as appropriate.

### 13.4 Categories of financial instruments

The Fund recognises all financial assets and liabilities at fair value, or at amortised cost, as detailed in the Statement of Accounting Policies.

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Financial assets at fair value | **4,405,708** | 4,427,768 |
| Financial liabilities at fair value | **27,302** | 104,503 |
| Financial assets at amortised cost | **318,292** | 321,740 |
| Financial liabilities at amortised cost | **152,048** | 120,040 |

### 13.5 Fair value measurements recognised in the Statement of Net Assets

The following table provides an analysis of the financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets to identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs, other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

## 13. Financial instruments *(continued)*

## 13.5 Fair value measurements recognised in the Statement of Net Assets *(continued)*

| 2019 | Level 1 $000 | Level 2 $000 | Level 3 $000 | Total $000 |
|---|---|---|---|---|
| **Financial assets at fair value** | | | | |
| Derivative financial assets | – | 69,946 | – | 69,946 |
| Insurance-linked assets | | | | |
| Asia & Australia | – | 105,434 | – | 105,434 |
| North America | – | – | 168,693 | 168,693 |
| Rest of the world | – | – | 100,583 | 100,583 |
| Investments in cash | | | | |
| Asia & Australia | 25,017 | – | – | 25,017 |
| NZ | 39,960 | – | – | 39,960 |
| Rest of world | 1,226 | – | – | 1,226 |
| Investments in equities | | | | |
| Asia & Australia | 353,132 | – | – | 353,132 |
| Europe | 375,079 | – | – | 375,079 |
| NZ | 199,897 | – | 145,158 | 345,055 |
| North America | 1,063,919 | 613,181 | – | 1,677,100 |
| Rest of the world | 15,799 | – | – | 15,799 |
| Investments in bonds | | | | |
| Asia & Australia | 40,422 | – | – | 40,422 |
| Europe | 81,623 | – | – | 81,623 |
| NZ | 586 | – | – | 586 |
| North America | 271,709 | – | – | 271,709 |
| Rest of the world | 25,122 | – | – | 25,122 |
| Investments in global private equity | | | | |
| North America | – | 95,108 | 192,295 | 287,403 |
| Investments in property | | | | |
| NZ | – | – | 1,442 | 1,442 |
| Investment in Style Premia Fund | | | | |
| North America | – | 420,377 | – | 420,377 |
| | 2,493,491 | 1,304,046 | 608,171 | 4,405,708 |
| **Financial liabilities at fair value** | | | | |
| Derivative financial liabilities | – | 27,302 | – | 27,302 |
| | – | 27,302 | – | 27,302 |

## 13. Financial instruments *(continued)*

### 13.5 Fair value measurements recognised in the Statement of Net Assets *(continued)*

| 2018 | Level 1 $000 | Level 2 $000 | Level 3 $000 | Total $000 |
|---|---|---|---|---|
| **Financial assets at fair value** | | | | |
| Derivative financial assets | – | 23,989 | – | 23,989 |
| Insurance-linked assets | | | | |
| Asia & Australia | – | 62,473 | – | 62,473 |
| North America | – | – | 150,698 | 150,698 |
| Rest of the world | – | – | 192,439 | 192,439 |
| Investments in cash | | | | |
| Asia & Australia | 38,622 | – | – | 38,622 |
| NZ | 20,927 | – | – | 20,927 |
| North America | 875 | – | – | 875 |
| Investments in commodities | | | | |
| NZ | – | 81,458 | – | 81,458 |
| Investments in equities | | | | |
| Asia & Australia | 462,066 | – | – | 462,066 |
| Europe | 353,484 | – | – | 353,484 |
| NZ | 242,489 | – | 110,872 | 353,361 |
| North America | 1,116,763 | 495,996 | – | 1,612,759 |
| Rest of the world | 21,118 | – | – | 21,118 |
| Investments in bonds | | | | |
| Asia & Australia | 61,449 | – | – | 61,449 |
| Europe | 116,736 | – | – | 116,736 |
| NZ | 564 | – | – | 564 |
| North America | 357,600 | 38,599 | – | 396,199 |
| Rest of the world | 24,345 | – | – | 24,345 |
| Investments in global private equity | | | | |
| North America | – | 117,512 | 102,715 | 220,227 |
| Investments in property | | | | |
| NZ | – | – | 3,349 | 3,349 |
| Investment in Style Premia Fund | | | | |
| North America | – | 230,630 | – | 230,630 |
| | 2,817,038 | 1,050,657 | 560,073 | 4,427,768 |
| **Financial liabilities at fair value** | | | | |
| Derivative financial liabilities | - | 104,503 | - | 104,503 |
| | - | 104,503 | - | 104,503 |

## 13. Financial instruments *(continued)*

### 13.5 Fair value measurements recognised in the Statement of Net Assets *(continued)*

#### *Movement of assets*

There were no transfers of assets between level 2 and 3 during the 2019 year.

Transactions during the year, within level 3 investments are outlined in the table below.

| **2019 Level 3 Investments** | **Insurance Linked** | **Property** | **Private Equity** | **Total** |
|---|---|---|---|---|
| | **$000** | **$000** | **$000** | **$000** |
| Opening balance Level 3 | **343,137** | **3,349** | **213,587** | **560,073** |
| Purchases during the year | **10,393** | **–** | **141,869** | **152,262** |
| (Losses)/gains for the year* | **(26,251)** | **3,982** | **13,418** | **(8,851)** |
| **Less return of capital** | **(58,003)** | **(5,889)** | **(31,421)** | **(95,313)** |
| **Closing balance at 30 June 2019** | **269,276** | **1,442** | **337,453** | **608,171** |

| **2018 Level 3 Investments** | **Insurance Linked** | **Property** | **Private Equity** | **Total** |
|---|---|---|---|---|
| | **$000** | **$000** | **$000** | **$000** |
| Opening balance Level 3 | 295,960 | 6,439 | 127,161 | 429,560 |
| Purchases during the year | 49,129 | – | 75,214 | 124,343 |
| Gains/(losses) for the year* | 29,136 | 998 | 18,154 | 48,288 |
| Less return of capital | (31,088) | (4,088) | (6,942) | (42,118) |
| Closing balance at 30 June 2018 | 343,137 | 3,349 | 213,587 | 560,073 |

**Income and dividends for these investments are shown within the interest, dividends and other income category on the Statement of Changes in Net Assets. The changes in fair value are shown within the increase in fair values of investment assets through profit or loss on the Statement of Changes in Net Assets.*

#### *Valuation techniques and inputs*

For fair value measurements categorised within Level 2 and 3 of the fair value hierarchy, an entity is required to disclose a description of the valuation technique and the inputs used in the fair value measurement. These are disclosed below.

| **Financial Asset** | **Fair Value as at 30 June 2019** | | **Fair Value as at 30 June 2018** | | **Valuation technique** | **Significant unobservable input(s)** | **Relationship of unobservable inputs to Fair Value** |
|---|---|---|---|---|---|---|---|
| | **Level 2 $000** | **Level 3 $000** | **Level 2 $000** | **Level 3 $000** | | | |
| **Derivative assets** | **69,946** | **–** | 23,989 | – | Valuation is derived using the Discounted cash flow techniques based on market exchange rates and interest rates | Not applicable | Not applicable |

## 13. Financial instruments *(continued)*

### 13.5 Fair value measurements recognised in the Statement of Net Assets *(continued)*

| Financial Asset | Fair Value as at 30 June 2019 | | Fair Value as at 30 June 2018 | | Valuation technique | Significant unobservable input(s) | Relationship of unobservable inputs to Fair Value |
|---|---|---|---|---|---|---|---|
| | Level 2 $000 | Level 3 $000 | Level 2 $000 | Level 3 $000 | | | |
| **Style Premia Fund** | **420,377** | **–** | 230,630 | – | Discounted cash flow techniques, forward contracts, spot rates and advice from specialised advisers | Not applicable | Not applicable |
| **International equities** | **613,181** | **–** | 495,996 | – | Discounted cash flow techniques using account comparable markets and advice from specialised advisers | Not applicable | Not applicable |
| **Global bonds** | **–** | **–** | 38,599 | – | Discounted cash flow techniques using forward interest rates and trading spreads | Not applicable | Not applicable |
| **Insurance linked assets - Asia and Australia** | **105,434** | **–** | 62,473 | – | Discounted cash flow techniques and option pricing models with reference to the current Fair Value and similar instruments | Not applicable | Not applicable |
| **Insurance linked assets - North America (Life Settlements)** | **–** | **128,099** | – | 150,698 | Discounted cash flow techniques | Mortality multiples and market rates for life settlements practices | The lower the mortality multiple the higher the Fair Value |
| **Insurance linked assets - North America** | **–** | **40,594** | – | – | Internal Valuation Committee pricing through the utilisation of Broker dealer pricing sheets | Seasonality curves provided by independent third party modelling software | The higher the curve the greater the Fair Value (and greater the risk) |
| **Insurance linked assets - Rest of World** | **–** | **100,583** | – | 192,439 | Internal Valuation Committee pricing through the utilisation of Broker dealer pricing sheets | Seasonality curves provided by independent third party modelling software | The higher the curve the greater the Fair Value (and greater the risk) |

## 13. Financial instruments *(continued)*

### 13.5 Fair value measurements recognised in the Statement of Net Assets *(continued)*

| Financial Asset | Fair Value as at 30 June 2019 | | Fair Value as at 30 June 2018 | | Valuation technique | Significant unobservable input(s) | Relationship of unobservable inputs to Fair Value |
|---|---|---|---|---|---|---|---|
| | Level 2 $000 | Level 3 $000 | Level 2 $000 | Level 3 $000 | | | |
| **Property** | **–** | **1,442** | – | 3,349 | Independent qualified value assessments taking into account market trends and yields | Local market conditions | The higher the latest sale return the higher the Fair Value |
| **Private equity** | **–** | **145,158** | – | 110,872 | Discounted cash flow and earnings multiple techniques | Revenue, earnings and associated valuation multiples, local market conditions and indicative quotes | The higher the latest sale returns and quotes of similar products the higher the Fair Value |
| **Global private equity** | **95,108** | **–** | 117,512 | – | Discounted cash flow and earnings multiple techniques | Revenue, earnings and associated valuation multiples, local market conditions. | The higher the latest sale returns and quotes of similar products the higher the Fair Value |
| **Global private equity** | **–** | **192,295** | – | 102,715 | Discounted cash flow and earnings multiple techniques | Revenue, earnings and associated valuation multiples, local market conditions and indicative quotes | The higher the latest sale returns and quotes of similar products the higher the Fair Value |
| **Commodities** | **–** | **–** | 81,458 | – | Discounted cash flow techniques using broker quotes | Not applicable | Not applicable |
| **Total** | **1,304,046** | **608,171** | **1,050,657** | **560,073** | | | |

### 13.6 Financial risk management objectives

The Fund is exposed to a variety of financial risks as a result of its activities. These risks include credit risk, liquidity risk and market risk (including currency risk, interest rate risk and price risk). The Fund's risk management and investment policies, approved by the Authority, seek to minimise the potential adverse effects of these risks on the Fund's financial performance.

These policies may include the use of certain financial derivative instruments to manage risk to within the approved limits.

## 13. Financial instruments *(continued)*

### 13.6 Financial risk management objectives *(continued)*

The Authority outsources the investment management to specialist managers, which provide services to the Fund, co-ordinate access to domestic and international investment markets, and manage the financial risks relating to the operations of the Fund in accordance with investment mandates set and monitored by the Authority. The Fund invests 85% of the value of its Investment assets (including cash) in a portfolio of equities and bond interest securities (2018: 84%). Exposure to market risks is diversified by direct investment in private equity, insurance linked assets and the Style Premia Fund. The Fund may also invest in derivative instruments such as futures and options.

The use of financial derivatives is governed by the Authority's SIPSP, which provides written policies on the use of financial derivatives. These policies permit the use of derivatives to change the Fund's exposure to particular assets. Derivatives cannot be used directly to leverage the Fund and the Fund's effective market exposure should not exceed the market value of its assets. Compliance with policies and exposure limits is reviewed by the Authority on a continuous basis.

### 13.7 Credit risk

Credit risk (as defined in the SIPSP) is the risk of default by a counterparty to a particular transaction or an issuer of a security held in the portfolio. Credit ratings for the securities is monitored on a regular basis and credit rating ranges are agreed with all Investment Managers. The Authority measures credit risk on a fair value basis. Credit risk associated with receivables is considered minimal. The largest receivables balance is in relation to investments sold, which are settled normally within three days of trade date. It is the opinion of the Authority that the carrying amounts of the financial assets represent the maximum credit risk exposure at balance date.

The Fund considers that it has significant credit risk exposure where an investment exceeds 5% of its net assets. As at 30 June 2019, the Fund has one investment exceeding 5% of the net assets (2018: two). Processes are in place to monitor and manage these investments.

During the year the Fund continued securities lending as a means of earning additional income from its investments. As at 30 June 2019, the Fund had approximately $151 million (2018: $94 million) lent out to counterparties. These assets have remained in the name of the Fund and were lent out against specific collateral, including cash, provided by the borrower with loans collateralised to a minimum of 100% (2018: 101%) at the borrower level. The Fund has direct access to the collateral in the event of default.

### 13.8 Liquidity risk

The Authority's approach to managing liquidity for the Fund is to ensure that it will always have sufficient liquidity to meet the Fund's liabilities as they fall due. The Fund is therefore exposed to the liquidity risk of meeting its share of the benefit payments. The Fund's listed equities and bond securities are considered to be realisable over a reasonable period of time, although with a market risk.

The Fund's liquidity risk is managed in accordance with the Authority's investment strategy. The Authority manages liquidity risk by maintaining cash, cash equivalents and short term investments, and through the continuous monitoring of forecast and actual cash flows and by

## 13. Financial instruments *(continued)*

### 13.8 Liquidity risk *(continued)*

seeking to match the maturity profiles of financial assets and liabilities. The Authority's overall strategy to manage liquidity risk remains unchanged from the previous year.

The following tables summarise the maturity profiles of the Fund's financial liabilities based on contractual maturities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities and based on the date on which the Fund can be required to pay. The tables include both interest and principal cash flows.

| | Less than 12 months $000 | 1-5 years $000 | 5+ years $000 | Total $000 |
|---|---|---|---|---|
| **2019** | | | | |
| Unsettled purchases | **147,218** | **–** | **–** | **147,218** |
| Derivative liabilities | **23,340** | **1,299** | **2,663** | **27,302** |
| Other financial liabilities | **4,830** | **–** | **–** | **4,830** |
| **Total** | **175,388** | **1,299** | **2,663** | **179,350** |
| **2018** | | | | |
| Unsettled purchases | 114,895 | – | – | 114,895 |
| Derivative liabilities | 95,870 | 5,884 | 2,749 | 104,503 |
| Other financial liabilities | 5,145 | – | – | 5,145 |
| Total | 215,910 | 5,884 | 2,749 | 224,543 |

### 13.9 Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: market interest rates (interest rate risk), foreign exchange (currency risk) and market prices (price risk). The Fund manages market risk by outsourcing its investment management; the investment managers manage the market risk in accordance with investment mandates.

The Fund's investment strategy is to invest in a diversified portfolio of equities and bond securities and it may also invest in derivative instruments such as futures and options. Exposure to market risks is diversified by direct investment in private equity, insurance linked assets and the Style Premia Fund.

#### *Interest rate risk management*

The Fund's activities expose it to the financial risk of changes in interest rates. Floating rate instruments expose the Fund to cash flow risk, whereas bond rate instruments expose the Fund to fair value interest rate risk. The Authority monitors the Fund's exposure to interest rate risk.

The following tables detail the Fund's exposure to interest rate risk on financial assets, based on contractual maturities, at the financial statement date. Interest rate risk is managed by the investment managers.

## 13. Financial instruments *(continued)*

### 13.9 Market risk *(continued)*

***Financial assets: Interest rate instruments***

| | Weighted average interest rate % | Less than 12 months $000 | 1-5 years $000 | 5+ years $000 | Total $000 |
|---|---|---|---|---|---|
| **2019** | | | | | |
| Cash and cash equivalent | **0.70** | **212,926** | **–** | **–** | **212,926** |
| Bond securities | **3.22** | **24,428** | **145,673** | **249,361** | **419,462** |
| **Total** | | **237,354** | **145,673** | **249,361** | **632,388** |
| **2018** | | | | | |
| Cash and cash equivalents | 0.36 | 253,011 | – | – | 253,011 |
| Bond securities | 2.89 | 45,232 | 261,043 | 293,018 | 599,293 |
| Total | | 298,243 | 261,043 | 293,018 | 852,304 |

***Interest rate sensitivity***

A significant change to interest rates will have a significant effect on the value and income of many of the assets within the Fund. It is difficult to quantify the effect of a change in interest rates in many of the asset classes such as the equity portfolios. The assets directly affected by a change in interest rates would be the global bond assets, insurance linked assets and the Fund's currency hedging portfolio.

The global bond portfolio has a benchmark duration of 7.10 years (2018: 7.05 years) and at the end of the year the portfolio was valued at $419 million (2018: $599 million). A 1% rise in interest rates would devalue the portfolio in the order of $29 million (2018: $42 million) (before tax) and conversely a 1% fall would increase the value by a similar amount.

The Fund hedges the foreign currency risk of its foreign assets back to NZD and has a benchmark of having 20% of the Fund in Foreign Currency. The Fund uses 3 month forward contracts and longer term (maximum 10 year) swaps to hedge the foreign assets. These currency hedges are sensitive to the spread between 90 day interest rates in NZ and other foreign currencies. A 1% change in the spread will change the accrual of income in the order of $31 million (2018: $29 million) (before tax) over a year.

***Foreign currency risk management***

Foreign currency risk is the risk that the market value of a financial instrument will fluctuate because of changes in exchange rates.

The Fund undertakes certain transactions and holds investment assets denominated in foreign currencies, hence it is exposed to the effects of exchange rate fluctuations. Foreign currency exposures are managed within approved policy limits and parameters set out in the SIPSP. The Fund enters into contracts designed to hedge some or all of its exposure to foreign currencies.

The Authority has a benchmark exposure to foreign currencies of 20% (2018: 20%) of the total Fund on a before tax basis. The Authority adjusts the Fund's foreign currency exposure in accordance with defined tilting rules that reflect the prevailing valuation of the NZD. The strategy is implemented by adjusting the hedge ratio on the international equities' portfolio.

## 13. Financial instruments *(continued)*

### 13.9 Market risk *(continued)*

| Asset Class | Before-tax Benchmark Hedge Ratio |
|---|---|
| Style Premia Fund | 100% |
| Catastrophe insurance | 100% |
| Commodity futures | 100% |
| Global bonds | 100% |
| International equities | 72% |
| Life settlements | 100% |
| Global private equity | 0% |

The Fund's total exposure to foreign currencies at the reporting date (after hedging) before tax was $1,034 million (2018: $1,009 million). The Fund's foreign exchange exposure, before taking into account hedging was $3,730 million (2018: $3,449 million).

#### *Foreign currency sensitivity*

The Fund is mainly exposed to the US dollar (**USD**), Hong Kong dollar, and the Euro. (2018: USD, Australian dollar and Euro).

The bond managers are responsible for managing the exposure to other currencies back to the USD, within the terms of their individual investment mandates. Another manager hedges the US dollar exposure to the NZD. For international equities the foreign currency exposure is hedged by a specialist manager back to the NZD within the limits approved by the Authority. The following table details the Fund's sensitivity to a 5 per cent decrease in the NZD on the unhedged exposure to foreign currencies.

| | Changes in NZD | Effect on surplus/ (deficit) after-tax and before membership activities | |
|---|---|---|---|
| | | **2019 $000** | **2018 $000** |
| Exchange rate risk | - 5% | **37,236** | 36,334 |

When the NZD weakens against other currencies there is an increase in the surplus after tax (and before membership activities). For a strengthening of the NZD against other currencies there would be an equal and opposite impact on the surplus, and the amounts above would be negative.

There have been no changes in the methods and assumptions used to prepare the foreign currency sensitivity analysis from the prior year.

#### *Market price risk*

Market price risk is the risk that the total value of investments will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment or its issuer, or to factors affecting all instruments traded in the market. The Fund has investments in equity instruments, bond instruments and derivative financial instruments, which expose it to price risk. The investment managers manage the other market risk in accordance with the Authority's SIPSP and their mandates.

## 13. Financial instruments *(continued)*

### 13.9 Market risk *(continued)*

As the Fund's financial instruments are carried at fair value, with changes in fair value recognised in the Statement of Changes in Net Assets, all changes in market conditions will directly affect investment income.

The following table illustrates the effect on the operating revenue and net assets from possible long term changes in market price risk on equities that the Fund was exposed to at reporting date:

| | Changes in variable | Effect on surplus/(deficit) after-tax and before membership activities | |
|---|---|---|---|
| | | **2019 $000** | **2018 $000** |
| Market price risk | + 5% | **125,062** | 117,131 |

## 14. Related parties

In terms of sections 81W (2), 88(2) and 95(1) of the GSF Act, the Minister of Finance pays into the Fund out of public money any deficiency in benefits payable to contributors and annuitants. During the year the Fund had business transactions with the Government, Crown Entities, and State-owned Enterprises, together with a number of other public sector entities.

The Authority manages the Fund's assets and administers the GSF Schemes. For the year ended 30 June 2019, the Fund transferred $44,612,000 (2018: $45,039,000) to the Authority for operating expenses, as detailed in the Statement of Changes in Net Assets. In turn, the Fund was reimbursed by the Government for 91% being $40,597,000 (2018: 90% being $40,535,000) and other employers for 9% being $4,015,000 (2018: 10% being $4,504,000). As at 30 June 2019 $3,927,000 was payable by the Fund to the Authority for expenses incurred but not yet paid (2018: $4,259,000).

## 15. Actual versus forecasts

Investment revenues are subject to the volatile nature of investment markets, this being the principal reason for the variance between the forecast and actual changes in fair value of investment assets. Funding for the Authority for operating expenses was below that forecast. This was the result of lower manager fees, custody costs and scheme expenses.

The forecast benefit payments are actuarially estimated and cannot be projected with accuracy as actual payments are dependent on factors beyond the Authority's control, such as inflation, early retirements, redundancies, unexpected salary changes, or transfers to other superannuation schemes.

## 16. Contingent assets, liabilities and capital commitments

As at 30 June 2019 capital commitments were in place for multiple Investment Managers. These are summarised as follows:

| | 2019 $000 | 2018 $000 |
|---|---|---|
| **Non-cancellable contractual commitments** | | |
| Less than one year | **179,918** | 258,972 |
| Between one and two years | **177,795** | 332,426 |
| Between two and five years | **97,300** | – |
| **Total non-cancellable contractual commitments** | **455,013** | 591,398 |

There are no contingent assets or liabilities (2018: Nil).

## 17. Subsequent events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements (2018: Nil).

## 18. Statement of Accounting Policies

The following significant policies have been applied in the preparation of the Financial Statements:

### 18.1 Reporting entity and statutory base

The Financial Statements of the Government Superannuation Fund (the Fund) are prepared pursuant to section 93 of the Government Superannuation Fund Act 1956 (GSF Act) and incorporate the Judges and Solicitor-General Superannuation Account and the Parliamentary Superannuation Account.

The Fund was established by section 13 of the GSF Act. It consists of various defined benefit superannuation schemes (**GSF Schemes**), as prescribed in the GSF Act. Pursuant to section 19H of the GSF Act, the GSF Schemes are treated as being registered on the managed investment schemes register under the Financial Markets Conduct Act 2013.

#### *Reporting requirements*

The Financial Statements have incorporated the requirements of *NZ IAS 26: Accounting and Reporting by Retirement Benefit Plans* with the provisions of relevant legislative requirements. The Fund is a profit-oriented entity domiciled in NZ.

### 18.2 Statement of compliance

The Financial Statements have been prepared on a going concern basis in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**), applying the NZ equivalents to International Financial Reporting Standards, and its interpretations (**NZ IFRS**), as appropriate for profit-oriented entities. The Financial Statements comply with International Financial Reporting Standards (**IFRS**).

## 18. Statement of Accounting Policies *(continued)*

### 18.3 Critical accounting estimates and judgements

The preparation of financial statements, in conformity with NZ IFRS, requires judgements, estimates and assumptions to be made that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

The estimates and associated assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised, if the revision affects only that year, or in the year of the revision and future years, if the revisions affect both current and future years.

Further detail on the material assumptions or major sources of estimation uncertainty that have a significant risk of causing material adjustments to the carrying amounts of assets are discussed in Note 13 (Financial Instruments). As with all investments their value is subject to variation due to market fluctuations. Receivables have been valued in accordance with NZ IFRS 9. Under this standard the Fund has adopted the simplified expected credit loss model for the current and prior year.

Significant Judgement has been applied in the measurement of financial assets and by the actuary in preparing the valuation reports. Further detail of the actuarial valuations is provided in Notes 11 and 12.

### 18.4 Measurement base

The measurement base adopted is that of historical cost, except for investment assets, including derivatives, which are measured at fair value.

### 18.5 Presentation and functional currency

The Fund is located in NZ, and the performance of the Fund is measured and reported in NZDs, rounded to thousands (**$000**) except as indicated. These Financial Statements are presented in NZD as that is the currency of the primary economic environment in which the Fund operates. The Fund's presentational and functional currency is therefore NZD.

### 18.6 Accounting policies

The following particular accounting policies, which materially affect the measurement of changes in net assets, net assets and cash flows have been adopted in the preparation of the Financial Statements.

#### *Investment income*

Interest income is recognised using the effective interest rate of the instrument. The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset or, where appropriate, a shorter period.

Realised and unrealised gains or losses on financial instruments are recognised in the Statement of Changes in Net Assets. Interest income on assets, designated at fair value, is accrued at balance date. Dividend income is recognised in the Statement of Changes in Net Assets on the ex-dividend date.

## 18. Statement of Accounting Policies *(continued)*

### 18.6 Accounting policies *(continued)*

***Benefits***

Benefits are recognised in the Statement of Changes in Net Assets when they become payable.

***Foreign currencies***

Transactions in currencies, other than NZD, are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance date, assets and liabilities, denominated in foreign currencies, are retranslated at the rates prevailing on balance date. Gains and losses arising on translation are included in the Statement of Changes in Net Assets for the year.

***Expenses***

All expenses other than benefits, recognised in the Statement of Changes in Net Assets, are accounted for on an accruals basis.

***Tax***

For taxation purposes, the Fund is classified as a portfolio investment entity (**PIE**). The income tax expense represents the sum of the tax liability for the year and includes deferred tax (if any). The taxation currently payable is based on taxable profit for the year. Taxable profit differs from profit before tax, as reported in the Statement of Changes in Net Assets, because it excludes items of income or expense that are never taxable or deductible, and it further excludes items that are taxable or deductible in other years.

Gains and losses on equities are non-taxable to the Fund. Taxable profit also requires that the Fair Dividend Rate (**FDR**) calculation method be applied to investments in overseas equities, which deems taxable income to arise regardless of the increase or decline in value of the investments. The Fund's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the Financial Statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

***Financial instruments***

Financial assets and financial liabilities are recognised in the Statement of Net Assets when the Fund becomes a party to the contractual provisions of the instruments. The Fund offsets financial assets and financial liabilities if the Fund has a legally enforceable right to set off the recognised amounts and interests, and intends to settle on a net basis. The Fund derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire. A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled, or expires.

***Investments***

Investments are recognised and derecognised on the trade date where a purchase or sale is under a contract, whose terms require delivery within the timeframe established by the market concerned, and are initially measured at fair value. Investments are designated at fair value.

## 18. Statement of Accounting Policies *(continued)*

### 18.6 Accounting policies *(continued)*

Fair values are determined after taking into account accrued interest on all applicable securities. Fair value is an estimate of the amount of consideration that would be agreed upon in an arms' length transaction between knowledgeable willing parties, who are under no compulsion to act.

Financial assets, designated at fair value, are measured at subsequent reporting dates at fair value, which is the exit price on the exchange on which the investment is quoted without any deduction for future selling costs. If a quoted market price is not available on a recognised stock exchange, the fair value of the instrument is estimated using accepted valuation techniques. Investments in units of pooled investment funds are valued at the closing price, or the value advised by the relevant investment manager.

***Government Superannuation Fund Business System***

All directly attributable costs, (less a previous allowance for impairment), for the Government Superannuation Fund Business System (**Business System**) have been capitalised. The Business System went live in November 2016. Amortisation of the capital costs began at that time.

***Securities lending***

Securities lending transactions are collateralised by securities or cash. The transfer of the securities to counterparties is only reflected in the Statement of Net Assets if the risks and rewards of ownership are also transferred. Collateral advanced by the borrower in the form of readily marketable securities (non-cash) is held in escrow by a third-party agent. Recourse of those securities is only available in the event of default by the borrower and, as such, the non-cash collateral is not recognised in the Statement of Net Assets. Collateral advanced by the borrower in the form of cash is recognised in the Statement of Net Assets as an asset, along with a corresponding liability to repay the cash collateral to the borrower, once the securities have been returned.

***Impairment***

Financial assets that are stated at amortised cost are reviewed at balance date to determine whether there is objective evidence of impairment. Expected credit losses are reviewed at each reporting date to reflect changes in credit risk since initial recognition of the financial assets.

The Business System, referred to in Note 8 to the financial statements, has been reviewed for impairment against NZ IAS 36: Impairment of Assets and no allowance for impairment was made in the current year.

***Trade and other receivables***

Trade and other receivables are carried at amortised cost and may include sales of securities and investments that are unsettled at balance date, and may also include dividends and interest. Dividends and distributions are accrued when the right to receive payment is established. Interest is accrued at balance date from the time of last payment.

***Trade and other payables***

Trade and other payables are not interest-bearing and are carried at amortised cost. Any outstanding trades are recorded on trade date and are normally settled within three business days. Purchases of securities and investments, that are unsettled at balance date, are included in payables.

## 18. Statement of Accounting Policies *(continued)*

### 18.6 Accounting policies *(continued)*

***Derivative financial instruments and hedge accounting***

Derivative financial instruments are contracts whose values are derived from changes in one or more underlying financial instruments or indices. The Fund's activities expose it primarily to the financial risks of changes in foreign currency rates and interest rates. The Fund may use foreign exchange forward contracts, commodity swaps and interest rate swap contracts to hedge these exposures. The Fund does not use derivative financial instruments directly for speculative purposes.

Derivative instruments are initially recognised at fair value on the date on which a derivative contract is entered into. They are subsequently re-measured at each balance date using either quoted sales prices or appropriate valuation techniques. Any gains or losses are taken to the Statement of Changes in Net Assets in the period in which they occur. Transaction costs are expensed on initial recognition.

The use of financial derivatives is governed by a Statement of Investment Policies, Standards and Procedures (**SIPSP**), approved by the Government Superannuation Fund Authority Board (the **Board**), which includes written policies on the use of financial derivatives. The Fund does not adopt hedge accounting.

***Goods and Services Tax***

The Fund is not registered for Goods and Services Tax (**GST**). All components of the Financial Statements are stated inclusive of GST where appropriate.

### 18.7 Forecast figures

The forecast figures are those presented in the Fund's 2018 Statement of Performance Expectations, being for the period 1 July 2018 to 30 June 2019. The forecast figures were prepared in accordance with the accounting policies adopted by the Fund for the preparation of the Financial Statements.

### 18.8 Standards issued but not yet effective

Certain new accounting standards and interpretations have been issued that are not mandatory for 30 June 2019 reporting periods and have not been adopted early by the Board. Initial assessment of these standards shows that none of these will materially affect the Fund.

### 18.9 Consistency in presentation

The same presentation and methods of computation have been followed in these financial statements as were applied in the preparation of the Fund's Financial Statements for the year ended 30 June 2018.

## 18. Statement of Accounting Policies *(continued)*

### 18.10 Changes in accounting policies and disclosures

The Fund applied NZ IFRS 9 and NZ IFRS 15 for the first time this year.

NZ IFRS 9 replaces NZ IAS 39: Financial Instrument- Recognition and Measurement for annual periods beginning on or after 1 January 2018. The new standard brings together all three aspects of the accounting for Financial Instruments – classification and measurement, impairment and hedge accounting. The classification and measurement requirements of NZ IFRS 9 did not have a significant impact on the Fund. The Fund continued measuring at fair value, all financial assets previously held at fair value under NZ IAS 39. NZ IFRS 15 replaces IAS 18: Revenue (and IAS 11: Construction Contracts) for annual periods beginning on or after 1 January 2018. The new standard establishes a comprehensive framework for determining when to recognise revenue and how much revenue to recognise. There was no impact from NZ IFRS 15.

Deloitte.

INDEPENDENT AUDITOR’S REPORT

TO THE READERS OF GOVERNMENT SUPERANNUATION FUND’S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2019

The Auditor-General is the auditor of Government Superannuation Fund (the Fund). The Auditor-General has appointed me, Michael Wilkes, using the staff and resources of Deloitte Limited, to carry out the audit of the financial statements of the Fund on his behalf.

## Opinion

We have audited the financial statements of the Fund on pages 29 to 61, that comprise the Statement of Net Assets as at 30 June 2019, the Statement of Changes in Net Assets and Statement of Cash Flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information.

In our opinion the financial statements of the Fund on pages 29 to 61:

- present fairly, in all material respects:
  - its net assets as at 30 June 2019; and
  - its financial performance and cash flows for the year then ended; and
- comply with generally accepted accounting practice in New Zealand in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Our audit was completed on 4 September 2019. This is the date at which our opinion is expressed.

The basis for our opinion is explained below. In addition, we outline the responsibilities of the Government Superannuation Fund Authority (the Board) and our responsibilities relating to the financial statements, we comment on other information, and we explain our independence.

## Basis for our opinion

We carried out our audit in accordance with the Auditor-General’s Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General’s Auditing Standards.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<table>
<tr><th>Key audit matter</th><th>How our audit addressed the key audit matter</th></tr>
<tr><td>Valuation of promised retirement benefits and unfunded deficit (Note 12)<br><br>In 1999 the Minister directed annual valuations to be carried out in accordance with Section 94 of the Government Superannuation Fund Act 1956.<br><br>On 21 August 2019, as disclosed in note 12 of the financial statements, the Fund obtained an actuarial valuation as at 30 June 2019 which estimated the gross promised retirement benefit at $12,585 million resulting in an unfunded deficit of $8,049 million. The vested benefit shortfall at 30 June 2019 amounted to $8,198 million.<br><br>The actuarial valuation is inherently subjective and is affected by use of assumptions such as:<br>• the rate of return on assets;<br>• the rates of salary growth; and<br>• the rates of pension increases.<br><br>As noted in Note 5 of the financial statements, there is no requirement on the Government to fully fund the Fund. Reliance is placed on the provisions in the Government Superannuation Fund Act 1956 for the Government to ensure that sufficient funds are available, or will be available, to pay benefits as they fall due.<br><br>We have included the valuation of the Fund’s gross liability for promised retirement benefits that has resulted in the unfunded deficit as a key audit matter due to its significance to the financial statements and the subjectivity of the assumptions inherent in estimating the amount of promised retirement benefits.</td><td>Our audit procedures included the following:<br>• Evaluating the Fund’s controls over benefits and contributions;<br>• Testing the underlying data provided to the actuary and confirming that these agree to the underlying records;<br>• Evaluating the professional competence and objectivity and relevant experience of the Fund’s actuary;<br>• Engaging our internal actuarial specialist to independently understand, challenge and evaluate:<br>– the work and findings of the Fund’s actuary;<br>– the actuarial methods and assumptions employed, specifically the rate of return on assets, rates of salary growth and the rates of pension increases.<br>• Evaluating the related disclosures about the Funds’ unfunded liability, and the risks attached to them which is included in Note 12 to the Fund’s financial statements;<br>• Assessing the related disclosures covering the Fund’s actuarial deficit and any plan by the Crown to fund benefit payments as they fall due.</td></tr>
</table>

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| **Valuation of level 3 investments**<br><br>As disclosed in Note 13.5 of the financial statements, the Fund has investment assets measured at fair value on level 3 fair value measurement consisting of insurance linked assets, private equities and property. These investment assets are managed by fund managers in accordance with the Fund's investment policies, standards and procedures.<br><br>At 30 June 2019, the fund reported level 3 investment assets of $608 million.<br><br>Level 3 investment assets are those derived from valuation techniques that include inputs that are derived from non-observable market data, which requires judgement.<br><br>Due to the judgements involved in valuing the level 3 investments, the valuation of these investments at 30 June 2019 has been identified as a key audit matter. | Our audit procedures included the following:<br>• Testing internal controls in place over the valuation of investments, which includes:<br>– the review of the custodian's internal controls report;<br>– the fund managers and the custodian's compliance statements to the Board; and<br>– the review by management of the tolerance reconciliations provided by the custodian.<br>• Obtaining an understanding of the valuation techniques and inputs used by the respective fund managers to determine the fair value of the investments;<br>• Performing a trend analysis by fund manager to analyse the movement in price and unit holdings;<br>• Reconciling the level 3 investments to the latest valuation reports or audited financial statements and assessing the reasonableness of any movements between the last valuation date and 30 June 2019; and<br>• Assessing the reasonableness of the disclosures required for level 3 financial instruments in the financial statements. |

## Responsibilities of the Board for the financial statements

The Board is responsible on behalf of the Fund for preparing financial statements that are fairly presented and that comply with generally accepted accounting practice in New Zealand.

The Board is responsible for such internal control as it determines is necessary to enable it to prepare financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board is responsible on behalf of the Fund for assessing the Fund's ability to continue as a going concern. The Board is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless the Board intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

The Board's responsibilities arise from the Government Superannuation Fund Act 1956.

### Responsibilities of the auditor for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers taken on the basis of these financial statements.

For the forecast information reported in the financial statements, our procedures were limited to checking that the information agreed to the Fund's statement of performance expectations.

We did not evaluate the security and controls over the electronic publication of the financial statements.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. Also:

- We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- We obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Board and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- We evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

From the matters communicated with the Board, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Our responsibilities arise from the Public Audit Act 2001.

## Other information

The Board is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the financial statements, and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Independence

We are independent of the Fund in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1 (Revised): *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board.

In addition to the audit we have carried out advisory services in relation to the PAMs remediation project, which are compatible with those independence requirements. Other than the performance of the advisory services, we have no relationship with, or interests in, the Fund.

**Michael Wilkes, Partner**

for Deloitte Limited

On behalf of the Auditor-General
Christchurch, New Zealand

# Statement of Responsibility

The Financial Statements of the Authority, for the year ended 30 June 2019, have been prepared in accordance with section 154 of the Crown Entities Act.

The Board is responsible for the preparation of the Financial Statements and the Statement of Service Performance, and for the judgements made in them.

The Board confirms that internal control systems have been established and maintained during the period to provide reasonable assurances as to the integrity and reliability of the financial and non-financial reporting.

In our opinion, the Statement of Service Performance set out on pages 16-19 clearly reflects the objectives of the Authority. The attached Financial Statements for the financial year fairly present the financial position, as at 30 June 2019, and the operations and cash flows of the Authority for the year ended 30 June 2019.

**Anne Blackburn**
*Chair*
*Government Superannuation Fund Authority Board*

**Shelley Cave**
*Chair, Audit & Risk Review Committee*
*Government Superannuation Fund Authority Board*

4 September 2019

# Statement of Comprehensive Revenue and Expense

## For the year ended 30 June 2019

| | Note | 2019<br>$000<br><br>Actual | 2019<br>$000<br>(unaudited)<br>Forecast | 2018<br>$000<br><br>Actual |
|---|---|---|---|---|
| **Revenue** | | | | |
| Interest received | | **30** | 20 | 29 |
| Transfer from the Government Superannuation Fund | 1 | **44,612** | 49,320 | 45,039 |
| **Total revenue** | | **44,642** | 49,340 | 45,068 |
| **Expenses** | | | | |
| Schemes administration | | **6,191** | 6,719 | 6,361 |
| Investment management and custody | 2 | **34,553** | 38,474 | 34,798 |
| Operating | 3 | **3,898** | 4,147 | 3,909 |
| **Total expenses** | | **44,642** | 49,340 | 45,068 |
| Net profit for the year | | **–** | – | – |
| Other comprehensive income | | **–** | – | – |
| **Total comprehensive income for the year** | | **–** | **–** | **–** |

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

GOVERNMENT SUPERANNUATION FUND AUTHORITY

# *Statement of Financial Position*

## As at 30 June 2019

| | Note | 2019<br>$000<br><br>Actual | 2019<br>$000<br>(unaudited)<br>Forecast | 2018<br>$000<br><br>Actual |
|---|---|---|---|---|
| **Equity** | | | | |
| General fund | | – | – | – |
| Total equity | | – | – | – |
| Represented by: | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | | **255** | 450 | 818 |
| Trade and other receivables | 4 | **4,026** | 3,502 | 4,408 |
| **Total current assets** | | **4,281** | 3,952 | 5,226 |
| **Total assets** | | **4,281** | 3,952 | 5,226 |
| **Current liabilities** | | | | |
| Trade and other payables | 5 | **4,281** | 3,952 | 5,226 |
| **Total current liabilities** | | **4,281** | 3,952 | 5,226 |
| **Net assets** | | **–** | – | **–** |

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 4 September 2019.

**Anne Blackburn**
*Chair*
*Government Superannuation Fund Authority Board*

**Shelley Cave**
*Chair, Audit and Risk Review Committee*
*Government Superannuation Fund Authority Board*

4 September 2019

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Statement of Cash Flows

## For the year ended 30 June 2019

| | Note | 2019 $000 Actual | 2019 $000 (unaudited) Forecast | 2018 $000 Actual |
|---|---|---|---|---|
| **Cash flows from operating activities[1]** | | | | |
| Cash was provided from: | | | | |
| Government Superannuation Fund[2] | 1 | **7,750** | 7,750 | 9,200 |
| Interest | | **30** | 20 | 29 |
| | | **7,780** | 7,770 | 9,229 |
| Cash was disbursed to: | | | | |
| Total expenses[2] | | **(8,343)** | (7,720) | (8,452) |
| Net cash flows from operating activities | | **(563)** | 50 | 777 |
| Net (decrease)/increase in cash held | | **(563)** | 50 | 777 |
| Opening cash and cash equivalents | | **818** | 400 | 41 |
| Closing cash and cash equivalents[3] | | **255** | 450 | 818 |

## Reconciliation of net operating result to net cash flows from operating activities

| | 2019 $000 Actual | 2019 $000 (unaudited) Forecast | 2018 $000 Actual |
|---|---|---|---|
| **Net operating result** | **–** | – | – |
| Movements in working capital items: | | | |
| Trade and other receivables | **382** | 282 | (222) |
| Trade and other payables | **(945)** | (232) | 999 |
| Net cash flows from operating activities | **(563)** | 50 | 777 |

[1] *Operating activities include all receipts of revenues and interest income, and payments of expenses.*

[2] *The Statement of Cash Flows has been completed on a basis that reflects the cash receipt/payments from the Authority bank account.*

[3] *Cash and cash equivalents consist of a current account held with a bank in NZ, used in the day to day cash management of the activities of the Authority.*

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Statement of Changes in Equity

## For the year ended 30 June 2019

| | 2019<br>$000<br><br>Actual | 2019<br>$000<br>(unaudited)<br>Forecast | 2018<br>$000<br><br>Actual |
|---|---|---|---|
| Equity at beginning of the year | – | – | – |
| Total comprehensive income for the year | – | – | – |
| **Equity at end of the year** | – | – | – |

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

# Notes to the Financial Statements

**For the year ended 30 June 2019**

## 1. Transfer from the government superannuation fund

In terms of section 15E (1) of the GSF Act, the administrative expenses of the Authority, including investment management and custody expenses, are reimbursed by the Fund.

## 2. Investment management and custody expenses

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Custody expenses | **1,186** | 1,322 |
| Investment management expenses | **33,367** | 33,476 |
| **Total investment management and custody expenses** | **34,553** | 34,798 |

## 3. Operating expenses

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Audit of financial statements | **238** | 215 |
| Board fees and expenses | **308** | 288 |
| Management fees – Annuitas | **2,549** | 2,581 |
| Other expenses | **803** | 825 |
| **Total operating expenses** | **3,898** | 3,909 |

## 4. Trade and other receivables

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Annuitas Management Limited | **40** | 79 |
| Government Superannuation Fund | **3,927** | 4,259 |
| Other receivables and prepayments | **59** | 70 |
| **Total trade and other receivables** | **4,026** | 4,408 |

## 5. Trade and other payables

| | 2019 $000 | 2018 $000 |
|---|---|---|
| Business System related costs | **207** | – |
| Investment management and custody expenses | **3,334** | 4,737 |
| Professional services and operating expenses | **711** | 444 |
| Other creditors | **29** | 45 |
| **Total trade and other payables** | **4,281** | 5,226 |

## 6. Financial Instruments

### *Credit risk*

Credit risk is the risk that a third party will default on its obligation to the Authority, causing the Authority to incur a financial loss. Financial instruments, which potentially subject the Authority to credit risk, consist principally of cash, cash equivalents and receivables. The Authority has a minimal credit risk in its holdings of these. The Authority does not require any collateral or security to support financial instruments.

There is no significant concentration of credit risk other than amounts due from the Fund, which in turn is funded by the Government in terms of section 15E of the Act.

The maximum amount of credit risk for each class is the carrying amount in the Statement of Financial Position.

### *Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Given that transactions in overseas currencies are recorded in NZDs at the rates of exchange prevailing on the date of payment the total exposure to currency risk is minimal.

### *Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

The Authority has no significant interest rate risk.

### *Liquidity risk*

The Authority manages liquidity risk by maintaining cash and cash equivalents and through the continuous monitoring of forecast and actual cash flows. The Authority's overall approach to liquidity risk remains unchanged from the previous year.

All the Authority's financial liabilities are expected to be paid within the next 12 months.

### *Fair values*

The fair values of financial instruments are equivalent to the carrying amounts disclosed on the Statement of Financial Position.

## 7. Board fees

Board members were paid the following fees during the year:

| | 2019<br>$ | 2018<br>$ |
|---|---|---|
| **Cecilia Tarrant, Chair,** *retired 30 June 2019* | **61,600** | 61,600 |
| **Craig Ansley,** *retired 30 June 2018* | **–** | 33,880 |
| **Anne Blackburn** | **30,800** | – |
| **Murray Brown** | **30,800** | – |
| **Shelley Cave** | **33,880** | 33,880 |
| **Angela Foulkes** | **20,533** | – |
| **Ainsley McLaren,** *retired 30 June 2018* | **–** | 30,800 |
| **Alison O'Connell** | **33,623** | 30,800 |
| **Michelle van Gaalen** | **38,500** | 37,473 |
| **Total Board fees** | **249,736** | 228,433 |

The Authority also met Board members' direct travel and other related expenses. Travel and other expenses totalled $30,508 in 2019 (2018: $44,434). The Authority continued with Directors' and Officers' insurance cover for Board members, and company reimbursement insurance in respect of any claims made by them, under indemnities provided by the Authority. The total cost of the insurance for the year was $17,231 (2018: $11,385).

## 8. Related party information

The Authority is an autonomous Crown entity.

The principal function of the Authority is to manage and administer the Government Superannuation Fund (GSF) and the associated GSF Schemes. For the year ended 30 June 2019, the Authority received $44,612,000 (2018: $45,039,000) for operating expenses as detailed in the Statement of Comprehensive Revenue and Expense. As at 30 June 2019, $3,927,000 was due from GSF for expenses incurred (2018: $4,259,000).

The Authority also entered into various transactions with Government entities on an arm's length basis in the normal course of business. The Authority continued with the resource sharing agreement with NZ Super to work jointly, on Responsible Investing Policies.

As at 30 June 2019 the Authority had appointed the Board Chair, Cecilia Tarrant, and the Deputy Chair, Michelle van Gaalen, as directors of Annuitas. The costs of running Annuitas are shared between the Authority and the National Provident Fund on an equitable basis, as agreed between the two parties. The Authority paid fees for this service during the year amounting to $2,549,000 (2018: $2,581,000). The amount owed by Annuitas to the Authority at year end was $40,000 (2018: $79,000).

The Board, through Management, monitors the performance of the external managers, appointed by the Authority to provide services to the Authority, and their adherence to the terms of their contracts, and co-ordinates actuarial, accounting, taxation, legal and communication services for the Authority.

There were no transactions between the Board members as individuals and the Authority, other than the payment of fees or expenses. There were no individual transactions with Management.

## 9. Actual versus forecast

Investment revenues are subject to the volatile nature of investment markets, this being the main reason for the variance between the forecast and actual changes in fair value of investment assets (within the Fund).

Transfers from the Fund are under that forecast. This is a result of lower than anticipated investment management and custody expenses (which are dependent on the value of the investment assets).

## 10. Contingent assets and liabilities

There are no contingent assets or liabilities at 30 June 2019 (2018: Nil).

## 11. Commitments

The Authority has commitments for the administration of the GSF Schemes, the provision of professional services, and for the provision of Management services from Annuitas. These commitments are summarised as follows:

| | 2019<br>$000 | 2018<br>$000 |
|---|---|---|
| Non-cancellable contractual commitments | | |
| Less than one year | **6,063** | 5,997 |
| Between one and two years | **5,232** | 5,853 |
| Between two and five years | **4,850** | 7,785 |
| **Total non-cancellable contractual commitments** | **16,145** | 19,635 |

In terms of section 15E (1) of the GSF Act, the administrative expenses of the Authority are reimbursed by the Fund. The expenses referred to in the above table are therefore reimbursed by the Fund as they are incurred.

## 12. Subsequent events

There have been no material events after balance date that require adjustments to, or disclosure in, the financial statements (2018: Nil).

## 13. Statement of Accounting Policies

The following significant policies have been applied in the preparation of the Financial Statements:

### 13.1 Reporting entity

The Government Superannuation Fund Authority (the **Authority**) was established in October 2001, as a Crown entity by section 15A of the Government Superannuation Act 1956 (**GSF Act**) (and subsequent amendments) and became an autonomous Crown entity under the Crown Entities Act 2004 in January 2005.

The Authority's primary function is to manage the Government Superannuation Fund (the **Fund**) and administer the GSF Schemes. The Authority does not operate to make a financial return and is domiciled in NZ.

The Authority has designated itself as a public benefit entity (**PBE**) for financial reporting purposes.

## 13. Statement of Accounting Policies *(continued)*

### 13.1 Reporting entity *(continued)*

Separate Financial Statements have been prepared for the Fund in terms of section 93 of the GSF Act.

### 13.2 Basis of preparation

The financial statements have been prepared on a going concern basis. All accounting policies, have been applied consistently to all periods.

#### *Statement of compliance*

The financial statements of the Authority have been prepared in accordance with the requirements of the Crown Entities Act 2004, which includes the requirement to comply with generally accepted accounting practice in New Zealand (NZ GAAP). The financial statements have been prepared in accordance with Tier 1 Public Sector PBE accounting standards, and comply with those standards.

#### *Presentation currency and rounding*

The financial statements are presented in NZDs and all values are rounded to the nearest thousand (**$000**).

#### *Standards issued but not effective*

Certain new accounting standards and interpretations have been issued that are not mandatory for 30 June 2019 reporting periods and have not been adopted early by the Authority. These standards will be adopted in the period in which they become mandatory.

### 13.3 Measurement base

The measurement base adopted is that of historical cost.

### 13.4 Accounting policies

The following particular accounting policies have been consistently applied in the preparation of the Financial Statements.

#### *Revenue*

Revenue is recognised on an accrual basis. Interest income is accrued at balance date using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

#### *Expenses*

All expenses recognised in the Statement of Comprehensive Revenue and Expense are accounted for on an accruals basis.

#### *Foreign currencies*

Transactions in overseas currencies are recorded in NZD's at the rates of exchange prevailing on the dates of the transactions with any currency gain or loss included in the Statement of Comprehensive Revenue and Expense.

## 13. Statement of Accounting Policies *(continued)*

### 13.4 Accounting policies *(continued)*

#### *Tax*

In terms of section CW 38(2) of the Income Tax Act 2007, the Authority is exempt from income tax.

#### *Financial instruments*

Financial instruments include both financial assets and financial liabilities. The Authority recognises a financial asset or a financial liability on the date the Authority becomes a party to the contractual provisions of the instrument. Financial assets include bank term deposits (if applicable), receivables from related parties and other receivables. Financial liabilities, measured at amortised cost, include trade, and other payables.

#### *Measurement*

Financial assets, classified as receivables, and other financial liabilities, are initially measured at fair value and subsequently carried at amortised cost using the effective interest rate method, less impairment losses, if any.

#### *Goods and Services Tax*

As the Authority manages superannuation schemes, its supplies are largely exempt for Goods and Services Tax (**GST**) purposes. GST is payable on certain overseas fees that would otherwise be subject to GST if received in NZ. GST on these items is included within operating expenditure on the Statement of Comprehensive Revenue and Expense.

#### *Impairment*

All assets are reviewed at balance date to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognised in the Statement of Comprehensive Revenue and Expense as the difference between the asset's carrying amount and the present value of estimated future cash flows.

#### *Derecognition*

The Authority derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the financial asset and the transfer qualifies for derecognition. A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

#### *Statement of Cash Flows*

The Statement of Cash Flows has been prepared using the direct approach.

#### *Accounting for Joint Ventures*

The Authority and the Board of Trustees of the National Provident Fund (**NPF**) have formed a joint venture company, Annuitas Management Limited (**Annuitas**). Each organisation has entered into a management services agreement with Annuitas. The main function of Annuitas is to provide staff (**Management**) who act in management and secretarial roles on behalf of the Authority and the NPF. The Authority has a 50% ownership in Annuitas, but does not equity account for Annuitas as this is deemed to be immaterial. The authorised, issued and paid up capital of Annuitas is $2.

## 13. Statement of Accounting Policies *(continued)*

### 13.5 Forecast figures

The forecast figures are those approved by the Board at the beginning of the period and presented in the Authority's Statement of Intent for the year commencing 1 July 2018. The forecast figures were prepared in accordance with NZ GAAP, and are consistent with the accounting policies adopted by the Board for the preparation of the Financial Statements.

### 13.6 Changes in accounting policies

There have been no material changes to accounting policies during the year.

Deloitte.

## INDEPENDENT AUDITOR'S REPORT

## TO THE READERS OF GOVERNMENT SUPERANNUATION FUND AUTHORITY'S FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2019

The Auditor-General is the auditor of Government Superannuation Fund Authority (the Authority). The Auditor-General has appointed me, Michael Wilkes, using the staff and resources of Deloitte Limited, to carry out the audit of the financial statements and the performance information, of the Authority on his behalf.

### Opinion

We have audited:

- the financial statements of the Authority on pages 68 to 78, that comprise the Statement of Financial Position as at 30 June 2019, the Statement of Comprehensive Revenue and Expense and Statement of Cash Flows for the year ended on that date and the notes to the financial statements including a summary of significant accounting policies and other explanatory information; and
- the performance information of the Authority on pages 16 to 19.

In our opinion:

- the financial statements of the Authority on pages 68 to 78:
  - present fairly, in all material respects:
    - its net assets as at 30 June 2019; and
    - its financial performance and cash flows for the year then ended; and
  - comply with generally accepted accounting practice in New Zealand in accordance with Public Benefit Entity Reporting Standards; and
- the performance information on pages 16 to 19:
  - presents fairly, in all material respects, the Authority's performance for the year ended 30 June 2019, including:
    - for each class of reportable outputs:
      - its standards of delivery performance achieved as compared with forecasts included in the statement of performance expectations for the financial year; and
      - its actual revenue and output expenses as compared with the forecasts included in the statement of performance expectations for the financial year; and
  - complies with generally accepted accounting practice in New Zealand.

Our audit was completed on 4 September 2019. This is the date at which our opinion is expressed.

The basis for our opinion is explained below. In addition, we outline the responsibilities of the Government Superannuation Fund Authority Board (the Board) and our responsibilities relating to the financial statements and the performance information, we comment on other information, and we explain our independence.

### Basis for our opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Key Audit Matters

We have determined that there are no key audit matters to communicate in our report.

### Responsibilities of the Board for the financial statements and the performance information

The Board is responsible on behalf of the Authority for preparing financial statements and performance information that are fairly presented and comply with generally accepted accounting practice in New Zealand. The Board is responsible for such internal control as it determines is necessary to enable it to prepare financial statements and performance information that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements and the performance information, the Board is responsible on behalf of the Authority for assessing the Authority's ability to continue as a going concern. The Board is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless there is an intention to merge or to terminate the activities of the Authority, or there is no realistic alternative but to do so.

The Board's responsibilities arise from the Crown Entities Act 2004, the Public Finance Act 1989 and the Government Superannuation Fund Act 1956.

### Responsibilities of the auditor for the audit of the financial statements and the performance information

Our objectives are to obtain reasonable assurance about whether the financial statements and the performance information, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers, taken on the basis of these financial statements and the performance information.

For the forecast information reported in the financial statements and the performance information, our procedures were limited to checking that the information agreed to the Authority's statement of performance expectations.

We did not evaluate the security and controls over the electronic publication of the financial statements and the performance information.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. Also:

- We identify and assess the risks of material misstatement of the financial statements and the performance information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- We obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board.

- We evaluate the appropriateness of the reported performance information within the Authority's framework for reporting its performance.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Board and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Authority's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements and the performance information or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Authority to cease to continue as a going concern.
- We evaluate the overall presentation, structure and content of the financial statements and the performance information, including the disclosures, and whether the financial statements and the performance information represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

From the matters communicated to the Board, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefit of such communication.

Our responsibilities arise from the Public Audit Act 2001.

### Other information

The Board is responsible for the other information. The other information comprises the information in the Annual Report, but does not include the financial statements, and our auditor's report thereon.

Our opinion on the financial statements and the performance information does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the financial statements and the performance information, our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the financial statements and the performance information or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

**Independence**

We are independent of the Authority in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1 (Revised): *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board.

Other than in our capacity as auditor, we have no relationship with, or interests, in the Authority.

**Michael Wilkes, Partner**

*for Deloitte Limited*

*On behalf of the Auditor-General*
*Christchurch, New Zealand*

# Directory

## As at 4 September 2019

### Government Superannuation Fund Authority Board

Anne Blackburn *(Chair)*
Murray Brown
Shelley Cave
Angela Foulkes
Alison O'Connell
Michelle van Gaalen

### Management

**Annuitas Management Limited**

| | |
|---|---|
| Simon Tyler | Chief Executive |
| Fiona Morgan | Chief Financial Officer |
| Philippa Drury | General Manager, Schemes |
| Paul Bevin | General Manager, Investments |

### Executive Office

Level 12, The Todd Building
95 Customhouse Quay
P O Box 3390
Wellington 6140

### Schemes Administrator

Datacom Connect Limited

### Custodian

JPMorgan Chase Bank, NA

### Investment Adviser

Russell Investment Group Limited

### Tax Adviser

PricewaterhouseCoopers New Zealand

### Actuary

Matthew Burgess, Towers Watson Australia Pty Ltd

### Auditor

Michael R Wilkes, Deloitte Limited (on behalf of the Auditor-General)

# Directory *(continued)*

## Bankers

Bank of New Zealand Limited *(Authority)*
ANZ Bank New Zealand Limited *(Fund)*

## Legal Adviser

DLA Piper New Zealand

## INVESTMENT MANAGERS

### Commodities

AMP Capital Investors (NZ) Limited *(terminated 31 July 2018)*

### Overlay Manager

State Street Global Advisors, Australia, Limited

### Global Bonds

Ashmore Investment Management Limited *(terminated 29 January 2019)*
Brandywine Global Investment Management, LLC
Pacific Investment Management Company, LLC
Wellington Management Australia Pty Ltd *(terminated 4 September 2018)*

### Style Premia

AQR Capital Management, LLC

### Insurance-Life Settlements

Apollo Global Management, LLC
Credit Suisse Securities (Europe) Limited

### Insurance – Catastrophe

Fermat Capital Management, LLC
Nephila Capital Limited

### Global Equities

Arrowstreet Capital Limited Partnership
Lazard Asset Management, LLC
Marathon Asset Management, LLP
PanAgora Asset Management, Inc
Pzena Investment Management, LLC

### Global Private Equity

Makena Capital Management (Cayman), LLC
StepStone Group, LP

# Directory *(continued)*

## NZ Equities

Devon Funds Management
Harbour Asset Management Limited

## NZ Private Equity

Direct Capital Management Limited
HRL Morrison & Co Limited
Pencarrow Private Equity Management Limited
Pioneer Capital Management Limited
Willis Bond and Company Management Limited

## Foreign Exchange Hedging

ANZ Bank New Zealand Limited
State Street Global Advisors, Australia, Limited

## All correspondence relating to the GSF Schemes should be addressed to:

Datacom Connect Ltd
GSF Schemes Administration
PO Box 3614
Wellington 6140

**or**

Chief Executive
Government Superannuation Fund Authority
PO Box 3390
Wellington 6140

GOVERNMENT SUPERANNUATION FUND AUTHORITY

# Statement of Investment Policies, Standards and Procedures

GOVERNMENT SUPERANNUATION FUND AUTHORITY

# *Statement of Investment Policies, Standards and Procedures*

This document is titled Statement of Investment Policies, Standards and Procedures (**SIPSP**) and is dated 4 September 2019 and supersedes all previous versions. An electronic copy is available on our website - *www.gsfa.co.nz.*



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The Authority may change the information in this document at any time and without providing any notice to any party of any changes.

# Contents

# 1 Introduction

## 1.1 The Authority

The Government Superannuation Fund Authority (the **Authority**) was established in 2001 to manage and administer the assets of the Government Superannuation Fund (**GSF** or the **Fund**) and the Government Superannuation Fund Schemes (**GSF Schemes**) in accordance with the Government Superannuation Fund Act 1956 and subsequent amendments (the **GSF Act**). The Authority is an autonomous Crown entity under the Crown Entities Act 2004 (**Crown Entities Act**).

## 1.2 Purpose

This Statement of Investment Policies, Standards and Procedures (**SIPSP**) records the arrangements set by the Authority's Board (the **Board**) for the governance and management of the investment assets held by the Fund. The Board's governance defines fiduciary roles and responsibilities, establishes the decision-making processes and the policies and procedures for management of the investment assets of the Fund.

## 1.3 The GSF Act

The Authority manages the assets of the Fund in accordance with the requirements of the GSF Act. Extracts from sections 15J (2), 15L and 15M of the GSF Act are set out below.

Section 15J (2) of the GSF Act requires that:

> *"The Authority must invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with -*
>
> *(a) best-practice portfolio management; and*
>
> *(b) maximising return without undue risk to the Fund as a whole; and*
>
> *(c) avoiding prejudice to New Zealand's reputation as a responsible member of the world community."*

Section 15L of the GSF Act requires that:

> *"(1) The Authority must establish, and adhere to, investment policies, standards, and procedures for the Fund that are consistent with its duty to invest the Fund on a prudent, commercial basis, in accordance with section 15J.*
>
> *(2) The Authority must review those investment policies, standards, and procedures for the Fund at least annually."*

Section 15M of the GSF Act requires that:

*"A statement of investment policies, standards, and procedures must cover (but is not limited to) -*

*(a) the class of investments in which the Fund is to be invested and the selection criteria for investments within those classes; and*

*(b) the determination of benchmarks or standards against which the performance of the Fund as a whole, classes of investment, and individual investments will be assessed; and*

*(c) standards for reporting the investment performance of the Fund; and*

*(d) ethical investment, including policies, standards, or procedures for avoiding prejudice to New Zealand's reputation as a responsible member of the world community; and*

*(e) the balance between risk and return in the overall Fund portfolio; and*

*(f) the Fund management structure; and*

*(g) the use of options, futures, and other derivative financial instruments; and*

*(h) the management of credit, liquidity, operational, currency, market, and other financial risks; and*

*(i) the retention, exercise or delegation of voting rights acquired through investments; and*

*(j) the method of, and basis for, valuation of investments that are not regularly traded at a public exchange; and*

*(k) prohibited or restricted investments or any investment constraints or limits."*

## 1.4 Review

The SIPSP is reviewed and approved at least annually by the Board. Only the Board can approve material changes to it. A version control document is maintained.

# 2 The Fund Management Structure and Governance

*Required under section 15M (f) - the Fund management structure.*

## 2.1 Policies

The Board is the governing body of the Authority and is responsible for all decisions relating to the Fund. The Board has all the powers necessary for managing, directing and supervising the management of the business of the Authority and the Fund. The Authority's key governance document is its **Corporate Governance Statement**, incorporating the requirements set out in the Act, the Crown Entities Act, other relevant law, and policies and practices developed by the Board. A copy of the Authority's Corporate Governance Statement can be found on the website – *www.gsfa.govt.nz.*

The Board has established an Investment Committee to which certain functions and powers are delegated. The Investment Committee has written terms of reference and its performance is reviewed annually.

The Authority and the Board of Trustees of the National Provident Fund have formed a joint venture company, Annuitas Management Limited (**Annuitas**), to engage staff (**Management**) to provide management services to each organisation. The Management Services Agreement between the Authority and Annuitas delegates authority to Management to enable it to carry out the day-to-day activity of the Authority and the Fund. This includes the management of functions contracted out to third parties for investment management, custody, scheme administration, legal, tax and advisory services.

In relation to investments, Management is responsible for the identification and implementation of appropriate strategies for the Authority to meet its obligations and objectives under the GSF Act. The Board retains the power of appointment of investment managers, custodians and external investment advisers. Management is delegated discretion to vary the Fund's asset allocation according to prescribed criteria and within prescribed limits pursuant to a dynamic asset allocation (**DAA**) programme.

## 2.2 Standards

a) A custodian is to be appointed to separate investment decision-making (undertaken by the investment managers) from the holding of assets and securities, transaction settlement, recording and reporting of investment activities (undertaken by the custodian).

   All the assets of the Fund, apart from cash holdings required for operational liquidity purposes, are to be held in custody unless specifically authorised by the Board.

b) Cash required for operational liquidity purposes is managed by Management.

c) Third party investment managers are to be engaged to invest the assets of the Fund.

## 2.3 Procedures

Selection of the custodian and managers is made in accordance with the Authority's policy on procurement of services. It takes into account, among other criteria specific to the role:

- best-practice portfolio management;
- the skills and experience of the manager compared to peers;
- the substance and viability of the manager;
- the costs that can be expected to be incurred;
- the potential for cost savings and other efficiency gains; and
- the existence of appropriate risk management procedures.

Selection of the custodian and investment managers will be contestable and conducted through a request for proposal and interview process unless specific circumstances require a different approach.

Investment mandates shall include guidelines setting out eligible investments, performance criteria, constraints and exposure limits, including use of derivatives and reporting requirements.

Managers are regularly reviewed against the criteria above to determine their ongoing suitability for their role.

Details of the current investment managers can be found on the website – *www.gsfa.govt.nz*.

# 3 Statement of Investment Philosophy

## 3.1 Policies

The Authority meets its responsibilities under the Act by developing and implementing:

- principles for best practice portfolio management;
- an investment strategy centred on maximising return over the long term subject to a defined risk limit; and
- responsible investment policies to meet the requirement to avoid prejudice to New Zealand's (**NZ**) reputation as a responsible member of the world community.

## 3.2 Standards

The Authority interprets best-practice portfolio management as:

- having a clear investment objective that reflects its statutory responsibilities and desired outcomes;
- maintaining a sound investment strategy consistent with that objective and the Authority's investment philosophy;
- having strong governance with clear assignment of responsibilities that promotes accountability, clear reporting and effective communication with the Fund's stakeholders;
- ensuring cost-effective management of investments by engaging an external custodian of its assets and managers with the requisite skills and alignment of interests with the Authority and monitoring their performance closely; and
- sharing relevant knowledge and resources with other Crown financial institutions, peer funds and experts.

The Authority's outputs and performance measures for investment must be designed to achieve these elements and measure success.

The Authority's investment philosophy must provide a foundation for its investment strategy. It must represent the Authority's views with regard to the sources of investment return and risk and how these can be captured cost effectively, having regard to the Authority's attributes:

- the nature of the GSF's pension obligations allows the Fund to take a long-term view for its investment strategy and tolerate short-term volatility in market prices and a degree of illiquidity;
- to promote the Crown's interests, the Fund's investments focus on returns after foreign taxes but before NZ taxes;
- implementation of the investment strategy is outsourced to third parties. The Authority determines investment strategy, selects and monitors external managers. Investment operational risk is managed by robust contractual arrangements with an independent custodian and the outsourced managers.

The Authority's Investment Beliefs are set out below. The Investment Beliefs are reviewed at least every four years.

| Investment Beliefs | Investment Strategy |
|---|---|
| **Asset Allocation** | |
| Risk and return are strongly related. Higher returns generally require acceptance of less-certain, more-volatile cash flows and market values.<br><br>Equity risk is the most pervasive and enduring source of additional return.<br><br>Other investment risks provide systematic returns for bearing risk, including compensation for the risk of inflation shocks, real interest rate shocks, currency shocks, credit defaults, insurance losses and illiquidity.<br><br>Other systematic returns (style premia) arise from investor behaviour, such as aversion to leverage, heavily discounted assets and going against the crowd.<br><br>Investors with long horizons are better able to capture these return sources than short term investors.<br><br>Asset allocation is the largest determinant of a portfolio's risk and return.<br><br>Diversification generally improves a portfolio's ratio of return to risk.<br><br>Significant exposure to international assets is worthwhile for NZ investors. Some foreign currency exposure also diversifies asset risk but forgoes any risk premium on the NZ dollar.<br><br>Although short term returns of risky assets are largely random, they are partly predictable in the longer term and tend to revert to a mean. | The Authority seeks returns in excess of NZ Government Bonds primarily by accepting additional investment risk.<br><br>Equity risk is the largest source of investment risk and excess return in the Fund. The Fund invests in other sources of systematic risk and return.<br><br>Because the Fund has a long horizon and meets only part of the GSF's pension obligations it can tolerate the volatility associated with a high level of equity risk.<br><br>The Fund seeks diversified exposures to rewarded non-traditional risk factors where practicable and consistent with its investment objectives.<br><br>The Fund generally has some foreign currency exposure to diversify risk.<br><br>Asset allocation may be varied within prescribed limits when market prices diverge widely from normal valuations. |

| Asset Class and Risk Factor Strategy | |
|---|---|
| Within asset classes, higher risk assets are not always rewarded with higher returns.<br>Risk premia that are compensation for risk of loss are expected to persist but may fluctuate significantly over time.<br>Returns derived from investor behaviour or market structure anomalies may not persist.<br>Diversified portfolios of securities can be built to capture risk and style premia without forecasting returns.<br>Investment strategies can be unbundled and emulated in part with derivatives to separate market risk premia from active trading strategies and their respective costs.<br>Markets are competitive and dynamic, varying in depth and the efficiency with which news is reflected in prices.<br>The more efficient a market is, the more difficult it is to generate returns better than the market persistently. | Passive investment in broad market representative portfolios is the default strategy to access return sources.<br>The fund invests in risk and style premia and uses derivatives to manage risk.<br>Active management is used where there is sufficient confidence in the ability of available investment managers to add value net of costs.<br>Active managers are benchmarked against replicable indices, where possible, that reflect the risk factors they attempt to capture.<br>Leverage is permissible within strategies where it can be measured and constrained within total portfolio risk limits. |
| **Manager and investment selection** | |
| True skill in generating additional return beyond systematic risk premia is rare and may not persist. But it is possible to identify superior active managers in certain markets or market segments.<br>Responsible investors act in accordance with broadly accepted global standards of ethical conduct in relation to business governance, environmental and social risks.<br>Environmental social and governance (**ESG**) factors affect the performance of companies, securities and investment portfolios presenting risks to be managed and opportunities to enhance returns. | Manager performance is monitored regularly against replicable benchmarks, where possible, net of fees and costs, to gauge added value.<br>The Authority does not invest in entities acting contrary to NZ's laws or international agreements and excludes direct tobacco investments. It is a member of the PRI. The Authority collaborates with other investors to engage with companies that breach its standards and excludes them when engagement is unlikely to improve outcomes.<br>The Fund's managers take account of material ESG factors in their investment processes where it adds value. |
| **Execution** | |
| Managing fees and implementation costs can improve the net return to investors. | Performance is measured net of fees and costs, and manager fees are compared regularly with market peers to ensure they are competitive. |

# 4 Asset Classes and Selection Criteria

*Required under section 15M (a) - The classes of investments in which the Fund is to be invested and the selection criteria for investments within those classes.*

## 4.1 Policies

The asset classes in which the Fund may invest are:

a) **Equities** comprising equity securities and securities convertible into equities and includes partly paid ordinary and preference shares.

b) **Property** comprising land and premises built on land and holdings in entities that invest principally in land and premises.

c) **Fixed interest** comprising interest-bearing securities issued or guaranteed by sovereign governments and agencies and issued by non-sovereign issuers.

d) **Cash and short-term securities** comprising NZ and foreign currency cash and interest-bearing securities with less than one year to maturity.

e) **Commodities** comprising futures contracts traded on recognised public exchanges.

f) **Insurance-linked** comprising securities providing exposure to natural catastrophe risks and longevity risks.

## 4.2 Standards

The Fund may invest in these asset classes through direct ownership of the assets, through collective investment vehicles that hold the assets (subject to section 15K of the GSF Act which prohibits the Fund having a controlling interest) or through derivative securities, such as futures, forward contracts, options and swaps.

The Fund's investments may be traded on recognised public exchanges or may be traded on private markets, subject to prudent limits approved by the Board.

Private market assets and securities are generally less liquid than their public market counterparts. They include collective investment vehicles that hold assets and securities, such as unit trusts, limited partnerships, hedge funds and fund-of-funds.

Private market assets are generally valued by appraisal, as described in section 12 - Valuation.

## 4.3 Procedures

The selection of individual investments within the various asset classes is delegated by the Authority to professional investment managers selected for their expertise in particular investment disciplines.

Each manager is mandated contractually to invest in a defined range of eligible investments, which may cover one or more of the asset classes above and is subject to limits of investment risk which are defined in the respective agreements with each manager.

# 5 The Balance of Risk and Return

*Required under section 15M (e) of the GSF Act – The balance between risk and return in the overall Fund portfolio.*

## 5.1 Policies

### Investment Objective

Maximise the Fund's excess return relative to NZ Government Bonds (before NZ tax) without undue risk of under-performing NZ Government Bonds measured over rolling ten-year periods.

## 5.2 Standards

### a) Reference Portfolio

The Board has adopted a Reference Portfolio for accountability and performance measurement purposes. The Reference Portfolio is a simple, notional portfolio that could be managed at low cost and return more than NZ Government Bonds while meeting the Fund's risk objectives. The long-term expected excess return of the Reference Portfolio varies somewhat over time. The Reference Portfolio also provides a benchmark to measure the Authority's performance in generating value-added returns. In 2018 the Board approved an increase in the percentage of international equities, and a decrease of fixed interest to occur by 30 June 2020. The old and new Reference Portfolios are set out in Table 1.

**Table 1: Reference Portfolio and Benchmarks**

| Asset Class | Weight as at 30 June 2019 (%) | Weight as at 30 June 2020 (%) | Benchmark |
|---|---|---|---|
| International Equities | 65 | 70 | MSCI All Country World Index |
| NZ Equities | 10 | 10 | S&P/NZX50 Gross Index including imputation credits |
| Fixed Interest | 25 | 20 | Bloomberg Barclays Global Aggregate Index |
| **Total Assets** | **100** | **100** | |
| Foreign currency exposure | 20 | 20 | |

### b) Target Portfolio

The Authority manages the Fund to a Target Portfolio that incorporates alternative risk premia and skill-based strategies and is expected to be a more efficient portfolio than the Reference Portfolio, i.e. improve risk-adjusted returns after fees and foreign tax. The current Target Portfolio is set out in **Appendix 1, Table 1**.

The Authority seeks to outperform the Reference Portfolio on a net-of-fees basis in two main ways:

- taking exposure to sources of return not represented in the Reference Portfolio that are considered to be systematic reward for bearing risk of loss. These alternative beta sources of return include illiquidity, style premia and insurance-linked risks for example; and
- capturing returns attributable to manager skill rather than systematic risk bearing, i.e. alpha.

### c) Dynamic Asset Allocation

From time to time the Authority may take temporary positions away from the Target Portfolio allocations in response to relative valuation signals. Those positions are expected to add returns as relative valuation returns to normal levels. The limits that each asset class may be tilted away from its Target Portfolio allocation are shown in **Appendix 1, Table 2.**

### d) Rebalancing Limits

Rebalancing limits define the extent to which the allocation to an asset class is permitted to deviate from the intended allocation (the Target Portfolio allocation plus any temporary changes in the allocation as a result of DAA decisions) before rebalancing trades are required.

Rebalancing limits are to be expressed as deviations around the intended allocation. Asset classes are to be rebalanced once the rebalancing limits are breached.

Asset classes or components of asset classes that are not able to be readily traded are not subject to formal rebalancing limits but are to be monitored to ensure their exposure does not become excessive relative to their intended exposure.

## 5.3 Procedures

### a) Review of Reference Portfolio

The Reference Portfolio is reviewed at least every four years taking into account the investment environment in which the Authority operates. The trade-off between risk and return is reviewed based on analysis of the prospective risk and return characteristics of each asset class in which the Fund might invest and their combinations.

### b) Review of Target Portfolio

The Target Portfolio is reviewed at least annually.

### c) Undue Risk

The Authority uses a number of short- and long-term risk metrics to determine ‘undue risk’, including performance under stress tests of worst rolling four quarters of historical scenarios and risk of expected under-performance versus NZ Government Bonds over the next 10 years.

## d) Rebalancing

Rebalancing takes place monthly to ensure the Fund remains aligned with the intended allocation taking into account known cash flows for the following month. The rebalancing ranges are set as a trade-off between the costs of being exactly at the intended allocation against the risk that variations in exposures will compromise the Fund's investment objectives. Rebalancing takes into account investments that are relatively illiquid, such as equity interests in collective investment vehicles that are not traded and have contractual restrictions on redemptions.

The rebalancing and reset limits (relative to the intended allocation) are shown in **Appendix 1, Table 3.**

## e) Foreign exchange exposure and hedging policies

The Authority expresses its desired foreign currency exposures relative to the total portfolio. The hedge ratio for international equities is varied to deliver the desired total Fund foreign currency exposure taking into account any hedging within other asset classes and any DAA tilts.

## f) Significant Asset Allocation Changes

Implementation strategies for significant asset allocation changes or the addition of new asset classes may include staged entry or exit programmes to achieve investing and divesting goals.

## g) Dynamic Asset Allocation

DAA tilts are implemented by the physical movement of assets (selling the asset to be under-weighted and buying the asset to be over-weighted) or via derivatives, where there is a well-developed market. In the case of currency tilts, forward currency contracts and basis swaps are used.

DAA decisions within limits approved by the Board are determined by Management. Those decisions and their investment performance impact are reported to the Investment Committee and to subsequent Board meetings.

# 6 Benchmarks

*Required under section 15M (b) – Determination of benchmarks or standards against which the performance of the fund as a whole, classes of investment, and individual investments will be assessed.*

## 6.1 Policies

The benchmark for the Fund as a whole is the Reference Portfolio. The Fund's performance is also assessed by comparing the Reference Portfolio's investment return to NZ Government Bonds, before NZ tax and after fees. The performance of individual asset classes or strategies is assessed by comparing their pre-tax performance with their respective benchmarks.

## 6.2 Standards

### a) Actual and Target Portfolio

The investment performance of the Actual and Target Portfolio is to be monitored relative to the Reference Portfolio. The Actual Portfolio represents the Target Portfolio plus any DAA tilts and asset valuation drift permitted within the rebalancing ranges.

The expected excess return of the Reference Portfolio above the S&P/NZX NZ Government Bond Total Return Index (NZ Government Bonds) over rolling 10-year periods is to be reviewed regularly.

### b) Asset Class and Strategy Benchmarks

For the purposes of assessing asset class or strategy performance, the relevant benchmarks set out in Table 2 are to be adopted.

**Table 2: Benchmark**

| Asset Class | Benchmark |
|---|---|
| International Equities | MSCI All Country World Index |
| NZ Equities | S&P/NZX50 Gross Index including imputation credits |
| Fixed Interest | Bloomberg Barclays Global Aggregate Index |
| Style Premia | US 3-month Treasury Bills |
| Global Private Equity | MSCI All Country World Index |
| Natural Catastrophe Risks | Swiss Reinsurance Catastrophe Bond Total Return Index |
| Longevity Risk | N/A[1] |
| Dynamic Asset Allocation | N/A[2] |

[1] *No benchmark is specified for the longevity risk (life settlements) investments because there is no single, reliable measure of market performance. Instead it is monitored relative to initial return expectations and general market returns for life settlements.*

[2] *The return attributable to DAA is determined based on the relative asset class benchmark returns.*

## 6.3 Procedures

a) The Fund's performance is assessed by comparing its return before NZ tax with the Reference Portfolio and the NZ Government Bonds. The Authority recognises that, from year to year, investment returns may not meet the expected excess return over NZ Government Bonds.

b) The Board monitors the before-tax, after fees, return of:

- the Fund's Actual Portfolio relative to the Reference Portfolio;
- the Fund's Target Portfolio relative to the Reference Portfolio; and
- the Fund's Actual Portfolio relative to the Target Portfolio.

c) Managers within an asset class may have specific benchmarks depending on their specific mandates. For example, in the case of international equities the MSCI All Country World Investible Markets Index, MSCI All Country World Index, the MSCI World Index and the MSCI Emerging Markets Index are used.

d) The performance of asset classes or strategies is assessed by comparing the actual performance of the investment managers with the benchmarks relevant to their respective mandates, plus any excess return target expected for active managers. Investment managers' performances are to be considered over periods not less than three years.

Investment performance is to be measured:

- net of any fees due to the investment managers; and
- after transaction costs (but before custodian costs).

Investment managers are evaluated after taking into account their investment management fees and the degree of risk incurred to achieve expected return targets. Investment managers are also compared to other managers in the same asset class or strategy.

# 7 Standards for Reporting

*Required under section 15M (c) - standards for reporting the investment performance of the Fund.*

## 7.1 Policies

A comprehensive and timely reporting framework enables the Board to analyse the performance of the Fund, asset classes and investment managers.

## 7.2 Standards

### a) Reporting by the custodian

For the Fund's investments as a whole, for each asset class and for each investment manager, the custodian is required to provide monthly reports to enable monitoring and review of the Fund and managers' performances. Those reports should include:

- the cash position of each portfolio;
- accounting matters including portfolio valuation;
  - reconciliation of portfolio values and cash flows with the investment managers;
  - investment performance measurement and comparisons with benchmarks;
  - tax reclaims; and
  - reports of compliance with mandate specific restrictions on separately managed portfolios.

### b) Reporting by investment managers

Reports from investment managers each month or quarter should cover (where applicable):

- details of securities held;
- a review of the performance and an analysis of performance factors;
- investment philosophy and strategy (if changed);
- certification that the terms of the investment contract have been met including certification that the portfolio has not been leveraged;
- annual external audit report; and
- compliance with responsible investment policies.

The Board reviews the managers' investment performances quarterly and investment managers are required to meet with Management, on behalf of the Authority, on at least an annual basis.

### c) Reporting by Management to the Board

Management will report on investment performance quarterly to the Board including aggregate returns and returns analysed by asset class and by manager. In each case actual returns are compared to benchmarks, expected risk measures, any active return targets and, in appropriate cases, peer returns. Summary reports are to be provided monthly of aggregate and asset class returns. Management should also report on responsible investment developments.

Management liaises regularly with the Treasury, which represents the Minister of Finance.

### d) Public Reporting

The Fund's investment performance is reported annually on the Authority's website – *www.gsfa.govt.nz* – and published each year in the Fund's Annual Report, which is tabled in the House of Representatives. A forecast for investment performance is published each year in the Authority's Statement of Performance Expectations.

For reference, the Treasury also reports to the Minister quarterly, following consultation with the Authority, on the Fund's investment performance and on key operational issues.

## 7.3 Procedures

The investment management agreements contain reporting provisions to enable the Board to determine each manager's compliance with the agreement and mandate, and success in meeting investment targets set for the manager. Similarly, the reporting functions provided by the custodian, including standards for timeliness, are described in the custodian's service level agreement.

Management reports to the Board on monthly rebalancing and DAA decisions.

# 8 Responsible Investment

*Required under sections 15M (d) – Ethical Investment, including policies, standards, or procedures for avoiding prejudice to NZ's reputation as a responsible member of the world community, and 15M (i) – the retention, exercise or delegation of voting rights acquired through investments.*

## 8.1 Policies

As noted in the Authority's Investment Philosophy (section 3.2), Responsible Investment (**RI**) encompasses more than maximising return for risk.

The Authority's RI policies encompass:

a) avoiding prejudice to NZ's reputation as a responsible member of the world community;

b) environmental, social, and governance considerations; and

c) the retention, exercise, or delegation of voting rights acquired through investments.

Where an investment is found to contravene the Authority's RI policies, the Board may engage with the issuer, exercise its voting discretion, or exclude or divest it from the Fund. Exclusion or divestment decisions may be reversed where subsequent advice indicates that the investment complies with the RI policies.

In addition to the application of its RI policies to the investments held in the Fund, the Authority:

- encourages the adoption of good corporate governance practices, including exercising voting entitlements consistent with maximising shareholder value and RI policies where possible;
- encourages investment managers to consider its RI policies and to integrate environmental, social and governance (**ESG**) factors into their investment analysis and/or engage with corporate entities as part of their investment process; and
- works with similar investors to enhance the effectiveness of its RI policies, which may include supporting collaborative initiatives and engagements.

## 8.2 Standards

Standards encompass direct investment in corporate securities (equity and debt), public debt and collective investment vehicles (**CIVs**).

The Authority may exclude securities issued by companies from the Fund. This may occur where companies are involved in certain activities or breaches of standards. In determining this, the Authority takes into account:

- NZ or national law
- International conventions to which NZ is a signatory
- Significant policy positions of the NZ Government
- Impact of exclusion on expected Fund returns
- Action of our peers
- Severity of breach/action
- Likelihood of success of alternative course of action (engagement).

The Fund will exclude investment in the government bonds of any nation state where there is widespread condemnation or sanctions by the international community and NZ has imposed meaningful diplomatic, economic or military sanctions aimed at that government.

The Authority may also exclude companies for breaches of the Fund's RI standards where engagement was unlikely to be effective due to the context of the company's operations or to a lack of responsiveness from the company to the issue.

Investment in CIVs may be a practicable and cost-effective way of achieving exposure to some investment opportunities. The Authority is prohibited by section 15K of the GSF Act from owning controlling interests in CIVs, however, and usually has little influence over the structure of the CIV, the individual securities it holds or its individual voting decisions. In applying the RI policies to a CIV, the Authority assesses value to the Fund of the CIV as a whole rather than each security it may hold. The Authority communicates its RI policies to managers of CIVs in which it invests and encourages them to consider whether its policies are appropriate for the CIV. In addition, the Authority will review its investment if there is a material change in its mandate or strategy.

Investment managers are delegated responsibility to exercise voting rights on behalf of the Authority but the Authority retains the ultimate voting right. Managers are required to vote in the interests of the Fund and their voting record is monitored. NZ managers are required to advise the Authority of their voting intent where the issue is likely to be publicly contentious, against the recommendation of an approved proxy voting service or give rise to a conflict of interest. In such cases, Management may direct the manager's votes under delegation from the Board. Managers' voting record is summarised on the website every six months.

The Authority's RI policies are reviewed regularly by the Board.

## 8.3 Procedures

The Board is accountable for the Authority's RI policies. The Authority has a collaborative agreement with the Guardians of the New Zealand Superannuation Fund (**NZ Super**) and the Accident Compensation Corporation, which have similar RI obligations and are signatories to the United Nations Principles for Responsible Investment2. The agreement encompasses policy development, identification and analysis of high RI risks, co-ordination of engagement and exclusion activities, engagement of research providers, research sharing and communications.

The parties to the agreement meet regularly to review current engagements and exclusions, high risk securities, research and policy development.

With the assistance of NZ Super, the Authority implements its RI policies by:

- monitoring high risk issues and securities;
- monitoring portfolio investments against the RI policies;
- analysing RI issues and appropriate responses;
- excluding securities as appropriate;
- communicating the Authority's policies and decisions to investment managers;
- participating in collaborative engagements with other investors;
- monitoring managers' voting records; and
- publishing its RI policies and exclusion decisions (individual company engagements may be confidential).

[2] *The UN principles for Responsible Investment can be viewed at www.unpri.org*

# 9 Risk Management

*Required under section 15M (h) – The management of credit, liquidity, operational, currency, market, and other financial risk.*

## 9.1 Policies

The Authority has developed comprehensive risk management policies for the management of various investment, operational and financial risks. The Audit and Risk Review Committee assists the Board in fulfilling its responsibilities with respect to internal controls, accounting policies, financial statements approval and risk management. Risk management is further supported by the Corporate Governance Statement, acceptable conduct policies for Board members and Management, Board expenditure policies and procedures, defined roles and responsibilities, performance accountability processes and timely disclosure and communication.

The level of investment risk in the Fund is defined by the Investment Objective and the Authority's risk management procedures described in section 9.3. A description of the major risk categories is set out below.

## 9.2 Standards

### a) Market risk

Market risk is the risk of adverse movements in investment markets (including asset prices, volatility, changes in the yield curve or other market related variables) that affect the value or income of the portfolio. Market risk is outside the control of the Authority. The volatility of investment markets means that the return from the Fund is inherently uncertain. Actual returns from each asset class may vary significantly each year from the mean returns assumed in determining the investment strategy appropriate to the long term.

Major structural changes to investment markets and/or taxation environment are not within the control of the Authority. However, the Authority takes into account changes in these risks in its reviews of the Reference Portfolio, Target Portfolio, DAA and asset class strategy.

### b) Borrowing or leverage risk

The Fund is not permitted to borrow money or charge any of the property of the Fund, directly or through financial instruments, without the Minister of Finance's consent. The Authority has sought and obtained the Minister's consent to enter into financial instruments that create leverage, where the use of those is consistent with the Authority's SIPSP. The Authority has also obtained the Minister's consent to enter into temporary overdrafts with its banks.

**Collective investment vehicles**

The Fund may own equity securities or invest in collective investment vehicles that borrow or grant charges on their own assets provided that owning these equity securities does not cause undue risk to the Fund as a whole, as expressed in the Investment Objective. Particular investments or strategies within collective investment vehicles may be leveraged or include leverage or be invested 'short' provided the overall risk of the CIV is acceptable.

(Short positions arise when securities are sold while not yet owned, in anticipation of being bought after the price falls. Short positions may be created physically by borrowing the securities and selling them or through derivative contracts.)

**Derivatives held directly by the Fund**

To avoid undue risk to the Fund as a whole, derivative positions held directly by the Fund are required to be collateralised. In general this means the Fund must hold sufficient cash or securities corresponding to the derivatives at current and prospective market prices to ensure the Fund remains within permitted risk limits at all times.

### c) Manager risk

The Authority retains external managers to implement its investment strategy and, in many cases, deliver superior returns through skilled active management. Managers' returns may vary from expected levels.

### d) Credit risk

Credit (or counterparty risk) is the risk of default by a counterparty to a particular transaction or an issuer of a security held in the portfolio.

### e) Liquidity risk

Liquidity risk is the risk that a security cannot be sold when required or that the price achieved is significantly less than the last quoted price without any fundamental change that justifies the lower price.

### f) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

### g) Currency risk

Currency risk is the risk that the foreign currency denominated assets will lose value due to the effect of an adverse exchange rate movement.

## 9.3 Procedures

### a) Market risk is managed by:

- specifying the total risk of the Fund and its various major exposures consistent with the Investment Objective and best-practice assumptions in relation to exposure risks and correlations among them;
- diversifying the asset classes in which the Fund invests by adopting the Reference Portfolio and Target Portfolio described in section 5 and a range of investment management techniques for the Fund;
- seeking professional advice on the investment strategy, the Reference Portfolio and the Target Portfolio;
- consulting with other Crown financial institutions and large investment funds;
- requiring investment managers to manage their portfolios within the market exposure limits for each asset class held as defined in the agreements with each manager; and

- setting limits to which managers are required contractually to manage their portfolios, which should include:
  - limits on the expected volatility of their total portfolio or their portfolio relative to the benchmark;
  - limits on concentration of exposure to any single issuer of securities; and
  - limits on particular exposures in the manager's benchmark and exposures not represented in the benchmark.

## b) Leverage risk is managed by:

- requiring any derivative transactions held directly by the Fund to be adequately collateralised with cash or corresponding securities, valued at current market prices;
- entering into commercial arrangements for any charges against the Fund in accordance with industry best practice, such as the use of agreed counterparty settlement limits and temporary overdrafts for forward currency contracts, swaps and other contracts for difference;
- requiring settlement of amounts outstanding from any derivative transactions due to short-term price fluctuations that exceed levels agreed in advance with counterparties;
- the Authority satisfying itself that managers (including managers of collective investment vehicles) have adequate policies and procedures relating to leverage and derivative counterparties and monitoring managers' adherence to their policies; and
- using appropriate industry standard documentation.

## c) Manager risk is managed by:

- robust selection process for investment managers based on demonstrated ability and independent expert opinion;
- diversification among managers;
- setting mandates for active managers based on best practice portfolio management that prescribe acceptable risk limits;
- regular assessment and review of manager performance against the agreed benchmark and peers; and
- putting in place management agreements or other satisfactory contractual terms that separate Fund assets from managers and protect against manager errors, omissions and wrongful actions.

## d) Credit risk is managed by requiring that managers of the Fund's credit investments:

- maintain the credit quality of their portfolios within agreed contractual guidelines and specified according to leading credit rating agencies;
- limit exposure to individual issuers to prescribed limits; and
- maintain policies and procedures relating to derivative counterparty selection and management and appropriate industry standard documentation.

e) Liquidity risk is controlled by implementing the Fund's Target Portfolio and rebalancing procedures described in section 5. In addition, liquidity risk is managed by:

- monitoring the Fund's liquidity quarterly against prescribed levels approved by the Board;
- requiring managers to invest only in securities listed on recognised exchanges, except as specifically authorised by the Board;
- limiting investment in securities that are not traded on recognised markets as authorised by the Board;
- requiring managers, within the terms of their individual investment management agreements, to hold diversified portfolios; and
- limiting the credit rating of the fixed interest and cash investments to levels as detailed in the agreements with each manager; and
- whenever an illiquid investment is considered, the projections of Fund liquidity, projected cash flows and illiquid investment obligations will be presented to the Board; and
- future cash flows of the Fund are included in any consideration of additional illiquid asset investments.

f) Operational risk is managed by:

- engaging an independent custodian to record transactions, report on performance and monitor compliance of investment managers with mandates;
- having a specific mandate for each investment manager, based on best practice portfolio management, except for investments in CIVs;
- separation of functions between investment management, custody, and specifying limits to the authority delegated to Management for dynamic asset allocation decisions;
- ensuring Management has sufficient resources to conduct the oversight function as part of its overall responsibilities;
- requiring fund transactions to be authorised by at least two persons; and
- requiring investment managers and the custodian to:
  - provide the Authority with assurances against operational risk events;
  - have in place insurance arrangements to cover claims in those events;
  - have in place and regularly confirm the existence and efficiency of internal policies and controls to address those risks;
  - provide compliance reporting; and
  - reconcile the Fund's recorded positions regularly.

g) Currency risk is managed by:

- maintaining a foreign currency hedging policy for the Fund and individual asset classes;
- engaging currency managers to manage the various hedging programmes;
- specifying the bounds within which investment managers may take on currency exposures relative to their benchmarks; and
- specifying the instruments that managers may use and the credit worthiness of the counterparties in the investment management agreement with each manager.

# 10 The Use of Derivatives

*Required under section 15M (g) – The use of options, futures and other derivative financial Instruments.*

## 10.1 Introduction

Derivatives are financial instruments whose value and characteristics are derived from underlying assets, indices or reference rates. Derivatives cover a broad range of financial instruments and include futures contracts, forward currency contracts, swaps, forward interest rate contracts, options and credit default swaps.

There is a variety of purposes for which it may be appropriate for the Fund to use derivatives. These include risk management, value adding investment strategies and transactional efficiency.

Derivatives provide another means for an investment manager to obtain market exposures and can be more liquid than the assets from which their value is derived.

Section 15C of the GSF Act requires the consent of the Minister of Finance to enter into derivative transactions. The Authority has sought and obtained the Minister's approval to use derivatives subject to certain conditions.

## 10.2 Policies

Derivatives may be entered into by the Authority or its managers on behalf of the Fund. Where managers or custodians use derivatives, their use must be specified in each investment management agreement, or be consistent with the terms governing collective investment vehicles.

Where the Authority is a counterparty to a derivative, the terms and conditions of the derivative must be specified in appropriate industry standard documentation.

The use of derivatives is permitted only where it results in market exposures appropriate to the Fund as a whole, the resulting counterparty exposures are adequately controlled and the Fund can meet any liquidity requirements arising from their use.

Derivatives, relating to foreign exchange, may be used for the purposes of managing and hedging currency exposures held within the Fund and for the purposes of purchasing or selling foreign currencies required for the settlement of foreign exchange transactions.

## 10.3 Standards

Derivative instruments may be traded on recognised exchanges or issued by a counterparty over-the- counter. Each such counterparty must meet the Fund's general requirements in terms of credit rating and contractual arrangements.

The net exposure to foreign currencies (after taking into account hedging positions) in the relevant portfolios is to be in accordance with the Authority's hedging policy for the asset class. If required, appropriate parameters for hedging using proxy currency will be established with the currency managers as well as appropriate operational ranges.

The effective exposures to underlying securities or assets arising from any derivatives are taken into account for the purposes of determining compliance with the prescribed exposure limits of portfolios.

## 10.4 Procedures

All investment managers using derivatives are required to provide the Authority with a copy of their policies relating to derivative securities trading and counterparty risk and to manage their derivative exposures in accordance with those policies. The Authority recognises that, where it invests in collective investment vehicles offered by investment managers, those vehicles may be investing in derivatives and takes that into account in determining the appropriate level of investment for the Fund.

The risk of derivatives is measured by their effective exposure to underlying assets as well as on a standalone basis. The value of derivatives is measured according to generally accepted industry best practice.

Over-the-counter foreign exchange hedging derivative contracts may be entered into only with counterparties that have credit ratings approved by the Board and measured by a recognised rating agency for counterparty risk and domiciled in NZ, or in countries with which NZ has a double tax treaty.

The currency exposure associated with international investing is managed using forward foreign exchange contracts or basis swaps relating to the currencies in which the securities that comprise the portfolio are denominated, or their close proxies.

The investment management agreements for those managers actively using forward foreign exchange contracts include limits for the maximum exposure per counterparty. For other types of derivatives, there are dollar limits for the maximum exposure before collateral is required.

Derivative policies and practices, including foreign exchange hedging, are in accordance with any selected manager’s derivatives policies, set out in their offer documents, or as otherwise specified in an investment management agreement. Selected managers are required to maintain policies and procedures relating to derivative counterparty selection and management accordingly and use appropriate industry standard documentation.

# 11 Investment Constraints

*Required under section 15M (k) – Prohibited or restricted investments or any investment constraints or limits.*

## 11.1 Policies

Prohibitions and constraints imposed by the Authority can be categorised as follows:

a) asset classes or strategies, which do not form part of the asset allocation;

b) investments excluded under the Authority's RI Policies;

c) investments outside the permitted investments of any investment mandate, or not included in the offer document of a collective investment vehicle; and

d) exposures outside the rebalancing range for each asset class, including ranges permitted pursuant to the dynamic asset allocation policy (to ensure the Investment Objective of the Fund is not compromised by excessive deviation from the Fund's Reference Portfolio and Target Portfolio).

In addition, the Authority is precluded from controlling any other entity or from holding such a percentage of the voting rights of another entity that would require it to seek control of that entity. See section 15K of the GSF Act.

## 11.2 Standards

The Authority will have developed constraints and limits in respect of each asset class or strategy to control risks. Each investment management agreement will specify those investments that constitute authorised investments and managers may not invest other than in those permitted investments.

Limits on the maximum holding that can be held in each issuer will address section 15K of the GSF Act and rebalancing ranges for each asset class or strategy will be recorded in **Appendix 1, Table 3.**

## 11.3 Procedures

Specific written authorisation from the Authority is required to invest outside of the prescribed permitted investments. The Board will consider such investments as they arise on application from the investment manager.

Rebalancing ranges are set out in **Table 3** of the **Appendix 1.**

# 12 Valuation

*Required under section 15M (j) – The method of, and basis for, valuation of investments that are not regularly traded at a public exchange.*

## 12.1 Policies

Many of the investments of the Fund are securities regularly traded on recognised exchanges and are valued independently and reported publicly. These investments are valued at current market value by the custodian in accordance with accepted industry best practice. Investments that are not regularly traded at a public exchange are valued according to the policies, standards and procedures in this section 12.

Where investments are not traded on recognised exchanges, but can be independently priced by the custodian, the Authority, in conjunction with the custodian, determines fair valuation on these investments through an objective or independent process where possible at least annually. Examples of investments that are not traded on recognised exchanges but that can be independently priced are: some collective investment vehicles, some non-sovereign bonds and over-the-counter derivative transactions.

Where a valuation discrepancy arises between an investment manager and the custodian, the Authority generally accepts the custodian's valuation.

For private market investments, that are either:

- not able to be independently priced by the custodian; or
- can be priced independently by the custodian, but at a cost determined by the Authority to be unreasonable, the Authority relies on the valuation provided by the investment manager using generally accepted industry standards that has either:
  - been undertaken by a reputable, suitably qualified professional valuer, who is independent of the investment manager; or
  - been determined by reference to observable market variables obtained from sources independent of the manager.

The Authority may seek independent advice from a suitably qualified professional valuer to verify or confirm the reasonableness of any valuation provided by an investment manager.

## 12.2 Standards

For unlisted securities, where quoted market prices are not available, fair value will be determined on the basis of independent valuation or by the application of generally accepted industry standards and subject to independent verification. Investments in collective investment vehicles will be subject to external valuation processes and valued according to generally accepted industry standards. In the case of over the counter derivatives, the mark to market method for determining the value is to be independently verified.

## 12.3 Procedures

Wherever possible, independent pricing measured at the most recent reporting dates will form the basis of the Board's fair value estimate, using the Standards in 12.2. In cases where an independent valuation is unable to be obtained, the Authority uses the closing price released by the relevant investment manager. Investments in collective investment vehicles, where underlying assets are not publicly traded, are subject to the Board being satisfied there are adequate and timely independent valuations and audit procedures to validate underlying valuations.

# Appendix 1

### Table 1: Target Portfolio as at 1 July 2019

| Asset Class | Weight (%) |
|---|---|
| International equities | 54.75 |
| NZ equities | 9.5 |
| Fixed interest | 11.25 |
| Style premia | 10 |
| Global private equity | 5.5 |
| Natural catastrophe risks | 6 |
| Longevity risks | 3 |
| **Total Assets** | **100** |
| Foreign currency exposure | 20 |

### Table 2: DAA Limits

| Asset Class | Limit versus Target Portfolio Allocation (%)[1] |
|---|---|
| Cash vs equities vs fixed interest | +/-10 |
| Developed market equities vs emerging market equities | +/-5 |
| NZ equities vs international equities | +/-2 |
| Developed market fixed interest vs emerging market fixed interest | +/-5 |
| Foreign currency exposure | +/-15 |
| Foreign currency majors vs NZD[2] | +/-10 |
| High yield credit vs governments vs investment grade credit | +/-5 |
| Commodities and/or property | +/-5 |

[1] *Although the ranges have been expressed as symmetric, short exposures are not permitted.*

[2] *Major currencies include USD, EUR, GBP, JPY, CHF, AUD.*

### Table 3: Rebalancing

| Asset Class | Rebalancing Limits (± %) |
|---|---|
| Combined Global public and private equities | 5 |
| Combined NZ public and private equities | 2 |
| Fixed interest | 4 |
| Style premia | 2 |
| Natural catastrophe risks | 2 |
| Longevity risks | 2 |
| Foreign currency exposure | 5 |

### Private Equity Limit

Total (domestic and global) invested private equities to not exceed 30% of total (domestic and global) invested private and public market equities.

GOVERNMENT
SUPERANNUATION FUND
AUTHORITY

GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga