



Dear Member

*Following the release of the annual reports of the Government Superannuation Fund Authority (*the Authority*) and the Government Superannuation Fund (*GSF* or *the Fund*) for the year ended 30 June 2009, I am pleased to provide you with this update on the management of GSF.*

Features of the 2009 year

- *Investment performance was severely impacted by the global financial crisis.*
- *Added value from active management of international and New Zealand equities.*
- *Exclusion of direct investment in companies involved in the manufacture of cluster munitions and nuclear weapons, in terms of the Authority's Responsible Investment Policies.*
- *Tender undertaken to identify an organisation to undertake the development of a new and more sustainable system to be used in the administration of the GSF Schemes.*

Board Members

Two new Board members were appointed in 2008, following the retirement of Basil Logan (the previous Chairman) and Colin Blair, earlier in the year. The Board is pleased to welcome Steve Napier and Keith Taylor.

Appreciations

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

The Board thanks the management team and staff for their high level of work and commitment to meeting the Authority's objectives.

A handwritten signature in dark ink, appearing to read 'Tim McGuinness'.

Tim McGuinness

Chairman, Government Superannuation Fund Authority Board

24 September 2009

Investments

The investment performance of the Fund during the year was severely impacted by the global financial crisis which started in 2007, but deteriorated sharply in 2008. The flow-on effects from the United States sub-prime mortgage crisis dominated the year and led to the worst downturn in investment markets since the Great Depression.

The crisis resulted in the biggest fiscal and monetary policy intervention since World War II. Government actions were taken to avert a generalised banking collapse, ensure sufficient liquidity to support economic activity, and underwrite toxic assets.

This situation was extremely difficult to predict at the start of the financial year. In July 2008 the international credit crisis had yet to gather pace and Lehman Brothers was still a respected name on Wall Street.

The downturn impacted on all investment funds invested in growth assets such as equities and property. The Fund was no exception. Notwithstanding its recent diversification into absolute return strategies, commodities and global tactical asset allocation, the market downturn could not be avoided. Fortunately, there has been some recovery in markets and the global economy through 2009.

The Board continues to focus on the long-term by making sure its strategy remains appropriate for a Fund that is expected to pay pensions for the next 60 years. This is achieved by broadly diversifying the Fund's investment exposures, and by maintaining a set of high quality investment managers capable of adding value. The Board is constantly seeking to enhance the management of the Fund to meet the statutory requirements of best practice portfolio management and maximising return without undue risk to the Fund as a whole. Current initiatives include a detailed investigation of the potential benefits of more dynamic asset allocation and the assessment of new asset classes.

Investing in a wide range of assets globally is prudent and the Board remains committed to that approach. Diversification of risk exposures and active management of investments, where appropriate, should enhance investment performance over time.

During the year, active management added value (when compared to benchmarks) for both New Zealand equities (+1.9%) and international equities (+2.8% before hedging costs), although returns on both asset classes were negative. Active fixed interest management suffered from investing too early in credit securities, but has recovered in the second half of the year. The Fund benefited overall from the diversification into a global multi-asset class fund and global tactical asset allocation, but total returns were impacted by the cost of hedging foreign exchange in a volatile market.

Investment Returns

The Fund's deficit after tax for the year of \$583.3 million represents a return of -16.8% (2008: -6.7%) on average net assets.

The Fund's Investment Performance Measure (IPM) is to compare the after tax return of the Fund with the NZX New Zealand Government Stock Gross Index return (after tax) plus 2.5% per annum measured over rolling 10 year periods. The table below compares the Fund's investment returns against the IPM over 1, 3 and 5 year periods ended 30 June 2009.

	<i>1 year %</i>	<i>3 years Annualised %</i>	<i>5 years Annualised %</i>
Fund	-16.8	-5.2	0.7
IPM	9.3	7.2	7.1

The Risk Parameter set for the Fund is to have no more than a 1 in 10 chance in any one year of a loss greater than 6.0% of the total Fund (after tax). As the Fund is now into its ninth year of a diversified investment strategy, a deficit greater than the Risk Parameter is not unexpected. However, a deficit of greater than 6% in successive years is an extreme event.

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

Responsible Investing

During the year the Board resolved to exclude direct investment in securities issued by a number of companies understood to be involved in the manufacture of cluster munitions and nuclear weapons on the basis that these companies' activities are inconsistent with the Authority's Responsible Investment Policies (RI Policies) and with international conventions to which New Zealand is a party.

The Authority has signed a collaborative agreement with the Guardians of New Zealand Superannuation (GNZS), the Earthquake Commission and the Accident Compensation Commission to share the research of the GNZS Responsible Investing Unit to assist the Authority in meeting its RI Policies.

Schemes

During the year a tender was undertaken to identify an organisation to undertake the development of a new and more sustainable system to be used in the administration of the GSF Schemes. The Board is reviewing the outcome of the tender, particularly the resources, experience and capability of the tenderers to undertake the work, the timetable and whether to undertake the project in stages, and the software language and development approach to be used in the project. Final decisions are likely to be made before the end of 2009.

The performance standards of the Schemes Administrator, Datacom, were reviewed over the year and new standards introduced from 1 July 2009. The new performance standards reflect current best practice in schemes administration and are more specific in terms of required turn around times. Datacom adopted, and was meeting, the new standards before the year end.

In April the Authority and Datacom implemented the decision made in Budget 2008, and subsequently confirmed by an amendment to the GSF Act, that from April 2009 the minimum cost of living adjustment applied to GSF annuities would be increased from 90% of the increase in the Consumer Price Index (CPI) to 100%. The lower than 100% increase in the CPI received by some annuitants continues to apply before April 2009.

Website

The Authority's website – www.gsfa.govt.nz continues to be an important part of the Authority's communications strategy and contains comprehensive information on both the Authority and the Fund. It explains how the Authority operates and gives all members and interested parties immediate access to the Fund's latest quarterly investment results, as well as any changes the Authority makes to its policies, Investment Strategy and personnel. The annual reports are available on the website.

GSFA

Highlights *for the* 2009 *Year*

Our Mission

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

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

Further Information

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