

The Treasury

Budget 2017 Information Release

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[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
[4]	to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial	6(c)
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[39]	to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)
[40]	Not in scope	

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Cost Benefit Analysis Template

Section A Descriptive Information

Vote	Finance
Responsible Minister	Minister of Finance
Initiative title	Incremental funding to maintain the governance of the Board of Guardians of New Zealand Superannuation

Funding Sought (\$m)	2016/17	2017/18	2018/19	2019/20	2020/21 & outyears	TOTAL
Operating	0.0	0.232	0.232	0.232	0.232	0.928
Capital	0	0	0	0	0	0

Problem Definition

A description of the problem or opportunity that this proposal seeks to address, and the counterfactual.

The proposal seeks additional funding to meet the cost increases required to maintain the services of the Board of Guardians of New Zealand Superannuation (GNZS) at an appropriate level to meet the governance and risk-management responsibilities of the Board in respect of managing and administering the \$30bn New Zealand Superannuation Fund (NZSF).

There are 4 contributors to the proposed increase in costs:

1. During the year ended 30 June 2016 an increase in all Board fees was approved by the Minister, which increases costs by \$0.193m per annum (given the historical underspend of GNZS appropriation, and assuming that all other operating expenses would be held constant in perpetuity, an assessment was made at the time that the increase in fees in isolation (i.e. excluding the cost of additional overseas Board members or an overseas board meeting) could be absorbed within the existing GNZS baseline). Refer T2015/2842, T2016/739, T2016/1124.
2. The residency mix of Board members has changed. During the year ended 30 June 2016 Mr G Walker resigned from the Board and Mr M Tume completed his 10 year term. Based on the recommendation of an independent nominating committee, 2 replacement Board members were appointed. One of these members resides in North America. There are now 2 Board members who reside overseas. As a result of the new appointment, and the greater in-person attendance at meetings of the existing international Board member (the Deputy Chair), the cost of Board members traveling to attend meetings has increased by \$0.190m per annum.
3. The cost of completing the external audit of GNZS has increased by \$0.008m.
4. A small cost contingency is proposed of \$0.021m. This is considered prudent to cover unexpected potential additional costs that may arise, for example, from further increases in audit fees or unforeseen additional travel costs.

The total of these cost increases is \$0.412m.

The increase is partially offset by the Board not holding an overseas board meeting each year (for which \$0.180m was previously allowed under the GNZS appropriation).

The counterfactual is that Board fees would have to be reduced and/or overseas Board members would not be able to attend all meetings in person. Either of these actions would have a detrimental impact on the operation of the Board of GNZS and

as a result the governance and risk management environment will be negatively impacted. This would in turn have a negative impact on the returns of the NZSF.

Initiative Description

A description of what the initiative will provide or produce and how this will address the problem or opportunity.

The initiative is to address the cost increases outlined above and will allow the GNZS Board to maintain a very high standard of governance and risk management of the NZSF.

NZSF is consolidated into the Crown balance Sheet. At the latest financial year end the net assets of NZSF were approximately NZD30bn.

NZSF is managed and administered by GNZS. At the head of GNZS is a Board, who have primary responsibility for establishing governance and risk frameworks in order to meet the requirements of the New Zealand Superannuation and Retirement Income Act as they apply to the NZSF.

The NZSF is composed of a large and complex number of assets, invested across the world. The weight of academic research concludes that the quality of governance has a material impact on the firm value for listed companies over time. There is increasing evidence to suggest better governance also leads to better risk adjusted returns for institutional investors. For NZSF to continue to be governed in accordance with its mandate, including best practice portfolio management, quality governance, including board members and ongoing support of those members is required.

Without appropriate funding the Board of GNZS would not be able to maintain governance and risk management at an appropriate level, with potential negative impacts on invested assets and returns of the NZSF.

The GNZS Board needs to be highly skilled to manage the NZSF in line with the requirements of the NZSF mandate.

Alternative Options Considered

Alternative options considered are:

1. A more passive investment strategy may allow for a scaled-down Board, although critical decisions such as the Reference Portfolio and the most efficient/effective way to execute the portfolio efficiently and in line with the NZSF mandate still requires a Board that meets best practice requirements.
2. A Board with fewer offshore resident members
3. Fewer Board meetings
4. Reduced attendance in person at Board meetings

Option one would be likely to result in reduced investment returns.

Options 2 to 4 inclusive would all have a negative impact on governance and risk management, and reduced investment returns would likely result.

In each of these cases the cost savings available would be minimal e.g. less than \$100,000 per annum in any case, and would be more than offset by the reduction in the investment return benefit that is generated by having a high performing Board e.g. consider the conservative illustration of a 1b.p. return generated on a \$30bn fund, which equates to \$3m per annum (see Impact Analysis below).

The GNZS Board have a strong track record in managing costs and ensuring there is a strong business case before committing expenditure.

Section B Impact Analysis

Impact Analysis

An explanation of who is impacted (winners and losers), what the impacts are (costs and benefits), and when the impacts will be realised and for how long. The impacts should be quantified and monetised if possible.

Insufficient Board funding would result in a lower quality Board, lower levels of governance and risk management, and as a result reduced investment returns over the life of the fund.

In the Guardians' Statement of Performance Expectations the entity quantifies the value added through active investing (1.0%). (This equates to \$300m). There are also numerous publications that discuss the value added by good governance and risk management. These provide reference points for assessing impact (see Willis Towers Watson and IMF reports attached to this bid as examples).

This submission proposes a cost increase of \$0.232m per annum. Based on a \$30bn fund (with no allowance for the time value of money) the fund return ratio required to breakeven is less than 1/10 of a basis point or \$0.232m per annum.

In order to provide some context, if one conservatively assumes an impact of avoiding value destruction to a magnitude of 1b.p., that would equate to \$3m p.a. on a \$30bn fund. This should give confidence that the required average \$0.232m p.a. to breakeven is a conservative estimate.

Impact Summary Table

Impacts - Identify and list \$m present value, for monetised impacts	Option/scenario		Assumptions and evidence (quantify if possible, and use ranges where appropriate)	Evidence certainty ¹
	1 (breakeven)	2		
Estimated impact on key outcomes				
			High quality Board results in higher investment returns through better governance and risk management	Medium
Cost of the Initiative				
Board specified cost increases	(4)		The increased cost per annum of \$0.232m. Comprised mainly of increased Board costs (\$0.193m p.a.) and increased travel costs (\$0.190m p.a.), mitigated in part by removing the budget for overseas Board meetings.	Medium
Government Benefits/(Costs)				
Avoid value destruction	4		If GNZS is unable to maintain appropriate governance and risk management levels then ultimately the NZSF investment performance will suffer. Avoiding an average of \$0.232m of lost value per annum would mean that the initiative would break even. This breakeven scenario is likely to be highly conservative. For example, if assuming 1bp pa. of value retention, which would equate to \$3m p.a.	Medium
Total Quantified Government Impact	4			Medium
Wider Societal Benefits/(Costs)				
Total Quantified Wider Societal Impact			N/A	
Net Present Value of Total Quantified Societal Impacts	0	-		Medium

¹ Rate your level of confidence in the assumptions and evidence as high (green) if based on significant research and evaluations that is applicable, medium (amber) if based on reasonable evidence and data, or low (red) if there is little relevant evidence. Colour the rating box for each impact.

Section C Conclusions

Conclusions

What is being recommended and why?

Providing increased funding to the GNZS Board will continue to improve the strong governance and risk management of the large, complex, global pool of assets represented by the NZSF, which account for >10% of total Crown assets. Investment returns are expected to more than cover the higher costs.

Overall Ratings

Value for Money	Strategic Alignment
5	5
Rating from 0-5. Consider monetised and unquantified impacts and evidence base.	Rating from 0-5. Consider alignment with government strategic direction and priorities, and cross-government action.
5 High value / return confident, 4 High/medium return likely, 3 medium/break even confident, 2 medium/break even likely, 1 low/break even unclear, 0 no returns / value loss	5 Strong alignment, 4 High alignment, 3 Some alignment, 2 Limited alignment, 1 Low alignment, 0 No alignment

Summary of monetised results

Use ranges for values where appropriate	Discount Rate	
	6% real (default)	3% real (sensitivity)
Net Present Value (NPV) ²	\$0m	\$0m
Benefit Cost Ratio (BCR) ³	1	1
Return on Investment (ROI) – Societal Total ⁴	1	1
Return on Investment (ROI) – Government ⁵	1	1

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- ² **Net Present Value (NPV)** - The NPV is the sum of the discounted benefits, less the sum of the discounted costs (relative to the counterfactual). This gives a dollar value representing the marginal impact on the collective living standards of all New Zealanders of the initiative, in today's dollar terms.
- ³ **Benefit Cost Ratio (BCR)** - The BCR is the ratio of total discounted benefits to the total discounted costs. A proposal with a BCR greater than 1.0 has a positive impact, because the benefits exceed the costs. The BCR is the same as the Return on Investment Societal Total, unless there are negative impacts in addition to the fiscal cost of the initiative. All negative impacts are included in the denominator for the BCR measure.
- ⁴ **Return on Investment (ROI) - Societal Total** - Calculate the ROI by dividing the discounted net change in wider societal impact, including benefits to government, by the discounted cost of the initiative. This can be interpreted as the impact for New Zealanders per dollar the government spends on the initiative, eg, for every \$1 the government spends on this programme, New Zealanders receive benefits of \$3.
- ⁵ **Return on Investment (ROI) – Government** – Calculate the ROI by dividing the discounted net change in impact for the government by the discounted cost of the initiative. This measures the discounted net marginal (fiscal) benefits to the government.

Supporting Evidence

Willis Towers Watson: The Investment Case for Better Asset Owner Governance

International Monetary Fund: Asset Owners and the Institutional Challenge of Long Horizon Investing

Ex-post Impact Evaluation Plan

How will you evaluate (after the programme has been rolled out) what the effect of the programme was, particularly on the impacts listed in Section B?

Data collection and impact evaluation method: Fund performance and governance activity is reported on extensively by the Guardians i.e. Annual Report, Quarterly Report. Monthly performance data and other information is also made available through the NZSF website.

Funding of evaluation: No additional funding would be required for evaluation of Board governance or fund performance as extensive reporting is already undertaken in this regard.

Completion dates, publication, and dissemination of findings to key stakeholders: In line with regular reporting schedule.

Appendix 1 One-page Intervention Logic

Intervention

Outputs
Value relative to counterfactual

Outcomes

Impacts

Increased cost to fund specified operating costs of the Board of GNZS:

\$0.232m per annum

Maintain appropriate governance and risk management for a complex global fund of \$30bn. Avoid value destruction from having inadequate governance and risk management.

Highly skilled, internationally connected Board resulting in greater confidence and security for New Zealanders that the NZSF is being appropriately managed.

Board specified cost increases:

The increased costs of \$0.232m per annum.

Avoid value destruction:

If GNZS is unable to maintain appropriate governance and risk management levels then ultimately the NZSF investment performance will suffer. Avoiding an average of \$0.232m of lost value p.a. would mean that the initiative would break even.