The Treasury

New Zealand Superannuation and Retirement Income Act 2001: Amendment to Section 59 Information Release

February 2023

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Cabinet Document Details

Title:	**Cabinet Paper: DEV-21-SUB-0233: Amendment of Section 59 of the New Zealand Superannuation and Retirement Income Act 2001**
Date:	**11 November 2021**
Creator:	Office of the Minister of Finance

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[36] 9(2)(h) - to maintain legal professional privilege

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Office of the Minister of Finance
Chair, Cabinet Economic Development Committee

Amendment of Section 59 of the New Zealand Superannuation and Retirement Income Act 2001

Proposal

1 This paper seeks agreement for legislative amendments to the New Zealand Superannuation and Retirement Income Act 2001 (the NZSRI Act), the primary legislation of the New Zealand Superannuation Fund (NZSF).

2 The proposed amendment to the NZSRI Act is to remove the restriction on the NZSF taking a controlling stake in businesses, reflecting the size, maturity and investment capability for the NZSF to optimise its direct investment strategy and engage in projects of strategic interest within New Zealand.

Relation to Government Priorities

3 This paper does not relate to a specific Government priority. However, increased flexibility could enable the NZSF's Super Build infrastructure product to deepen and differentiate our capital markets to respond to priorities, particularly in Housing and Climate Change.

Executive Summary

4 Section 59 of the NZSRI Act prohibits the NZSF from holding a controlling interest in entities. This restriction was incorporated in the fund's 2001 founding legislation due primarily to its purpose being to get exposure to investments and not own businesses. In its nascent stage, the NZSF was relatively small and had not developed mature investment practices.

5 Since then, the NZSF has developed its size, capability and operating model. A recent Treasury review concluded that removing the control restriction will widen the investible universe for the NZSF, which may bring performance and competitive advantages. Allowing the NZSF to hold controlling interests will have a limited impact on competition with other market investors because the size and scale of the NZSF's direct investments differentiate them from the market.

Background

6 Under its founding legislation, the Guardians of New Zealand Superannuation (the Guardians) is prevented from holding a controlling interest in entities. The original policy rationale for the control restriction was that if the Government wished to take ownership of businesses it would have a policy rational for doing so. The NZSF was also of low maturity and direct investments were uncommon within the global practice of investment management when the fund was established in 2001.

7 Since then, the NZSF has significantly matured in terms of size, capability and operating model. The Guardians' governance has evolved in line with NZSF's investment capability, to provide effective oversight of complex investment strategies. Internationally, direct investment[1] is a much more common feature of best practice portfolio management than in 2001.

8 The Guardians has previously requested an amendment to section 59. Following a 2011 review, Treasury recommended changing the law to allow the Guardians to create and control Fund Investment Vehicles (FIVs).[2] This means that at present, while it could have a majority stake in entities for the purpose of making investments, it cannot take a controlling stake in investee businesses. This was on the basis that there was no strong evidence that control could deliver superior risk adjusted commercial returns to an investee of the size and nature of NZSF.

9 Since the last review in 2011 the NZSF has grown from $19 billion to $59 billion, and the projected future size of the NZSF is now significantly greater.[3] This has had a material impact on its investment strategy, which has evolved to include a greater proportion of direct and unlisted investments. At this scale, the NZSF is less likely to present competition to other investors and instead provides differentiation to the capital markets in New Zealand.

Analysis

Rationale for Change

10 The relaxation of the control restriction would deliver wider benefits to the Crown and NZ Inc. These include:

10.1 The potential for economic development through enabling a more attractive environment for domestic investment, particularly in the infrastructure space.

10.2 Differentiation of capital markets: a large institution with a counter-cyclical risk appetite would be highly responsive in a crisis, supporting businesses where other financial market participants might see a tightening risk appetite.

11 The NZSF currently targets direct investments with a minimum size of $200 million to $300 million. This is a self-imposed ticket size restriction which effectively caps the maximum number of investee companies, allowing for greater focus and mitigates monitoring risk.

1 The reference to Direct Investment in this paper refers to internal capability to invest in private unlisted assets.

2 FIVs are similar to Special Purpose Vehicles and are entities formed or controlled by a fund for the purpose of holding, facilitating or managing investments in the fund. A similar amendment was made in respect of the NZSF in 2015.

3 Current modelling projects the NZSF to be over $100 billion by 2030.

12 As the NZSF can only take on a minority stake in businesses, it must generate effective partnerships to influence the commercial outcomes of those businesses. The ability to find the required partners that can invest alongside a minimum ticket size of this magnitude has become challenging. This minimum investment size will only grow as the NZSF continues to grow, presenting an increasing challenge into the future.

13 The removal of the control restriction would provide access to a wider group of viable investment partners and opportunities in New Zealand and enable more of a principal/minority investor partnership. This could attract institutional investors who are comfortable with the Guardians' due diligence practices, deepening capital markets for domestic transactions particularly as the Guardians look for scalable investment opportunities such as strategic infrastructure. It would also provide a larger opportunity set for New Zealand investments and potential to increase the risk adjusted return of the NZSF.

14 Enabling increased direct investment would help bring the fund into line with global peers. Typically, as sovereign wealth funds (SWFs) mature and develop their internal expertise, more capital is managed in-house and a number of funds have graduated to taking on the ability to own businesses. The evolution of the NZSF aligns with the notion that as the fund grows and matures it may seek out a lead investor role. Maturity here refers to capability, operating model and size.

15 The Guardians has provided assurance that it can be granted the flexibility of a direct investment model. It has a reputation of being world leading in environmental, social or governance (ESG) integration and has a strong commitment to using its influence as a shareholder to encourage companies to manage and report on their ESG risks.

16 Majority ownership brings a greater ability to influence the company in terms of risk prevention, the application of sustainable finance principles and how issues are managed when they arise, for example, commercial risks or reputation through responsible investment issues. While this also increases the risk of adverse outcomes, I am comfortable that the Guardians' quality governance and ability to control outcomes introduces a lever to control these risks.

Risks

17 Key concerns are consistent with those of other SWFs which hold controlling interests, namely a perception risk – that actions are viewed through non-commercial lens. This could be through political pressure to undertake specific investments and reputational risks to the Crown should business investments underperform, including bail out expectations. [36]

18 Linked to the issue of political pressure is an expectation that SWFs, as large, direct shareholders, can be called on to take a more active investment

4 Section 49 Public Finance Act 1989.

management approach which creates political concerns.[5] The Guardians' legislated mission is to maximise returns over a long-term horizon without undue risk. Whilst the fund can support public policy objectives, this should only occur where it helps deliver the appropriate risk-adjusted commercial returns.

19 These risks cannot be fully mitigated but can be minimised through strong governance, transparency and effective accountability mechanisms. The quality of governance for the Guardians has evolved in line with the NZSF's investment capability to provide strong oversight of complex investment strategies. This governance capability has been validated by the most recent independent review of the Guardians.

20 On balance, I consider the opportunities and strategic benefits for the NZSF outweigh the original policy intent to restrict taking on a controlling interest in entities.

Options

21 The relaxation of the restriction could take the form of an amendment or a complete removal. I favour a full removal of the control restriction with the caveat that this decision should be reviewed within ten years. The purpose for a time-bound review is i) to consider the impact that the change in legislation has had on the NZSF and a wider set of stakeholders and ii) continue to monitor the restriction relative to the size of the NZSF over time.

22 While this preference is for a complete removal of the restriction, I consider this to be a transfer of investment accountability from policy makers to the Board.

23 I recommend that the Board of the Guardians establishes a new Statement of Investment Policies, Standard and Procedure that requires appropriate policy and oversight of how the NZSF direct investment strategy is given effect, including where the option to take a controlling stake is utilised.

24 This would require a further amendments to the NZSRI Act. The requirement in section 71 of the Act for an independent performance review of the NZSF every five years includes a mandated requirement to review the section 61 policies, thereby enabling Ministerial oversight for how the Board gives effect to the direct investment and controlling interest policy.

25 Should any secondary policy issues arise in the drafting process, these would be worked through under delegated authority from Cabinet.

Financial Implications

26 There are no financial implications from the proposal in this Cabinet paper.

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5 *The Rise of Collaborative Investing – Sovereign Wealth Funds' New Strategies in Private Markets*, BCG – Sovereign Investment Lab joint report, http://www.bernardobortolotti.com/wp-content/uploads/2019/08/Sovereign-Wealth-Funds-Approach_LOWRES_V11.pdf

Legislative Implications

27 Legal review and consultation with the PCO will occur concurrently to Ministerial consultation. This will be updated before submission to DEV. However, it is Treasury's view that there are limited legislative implications associated with the proposed amendments.

28 This bill does not have a place on the Legislative Programme. The amendment is not particularly time sensitive, but it is in all stakeholders' interests to gain momentum on the legislative process. The Guardians' interest in supporting strategic investments is a priority for me, therefore, I recommend including the bill in the 2021 Legislation Programme, with a priority category 5 (instructions to be provided to PCO in the year). Subject to approval with this approach, I am aiming to introduce this bill by March 2022.

Impact Analysis

Regulatory Impact Statement

29 Treasury's Regulatory Impact Analysis Team has determined that the proposal to loosen control restrictions of the NZSF is exempt from the requirement to provide a Regulatory Impact Statement on the grounds that it has no or only minor impacts on businesses, individuals, and not-for-profit entities. The substantive changes to the NZSF has been assessed and analysed in the report "NZ Super Fund: Controlling interest in entities" attached in [Appendix 1].

Population Implications

30 There are no meaningful population implications expected.

Human Rights

31 The proposals in this paper are not in any way inconsistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

32 The Guardians of New Zealand Superannuation has been consulted during the policy development for this legislative change.

33 The following government agencies have been consulted on this Cabinet paper:

33.1 The Infrastructure Commission

33.2 The Accident Compensation Corporation

34 No concerns have been raised.

35 The Department of the Prime Minister and Cabinet has been informed of this Cabinet paper.

36 Section 73 of the NZSRI Act sets the expectation for consultation with the Guardians, who have been fully engaged in policy development, and the National

Party who are listed as in agreement with Part 2 of the Act. The National Party will be consulted as part of the legislative process.

Communications

37 As this is a narrow in scope and straightforward legislative change and impacts the Guardians of New Zealand Superannuation only, I recommend communicating this change through a press release.

Proactive Release

38 This paper will be proactively released within 30 business days of decisions being confirmed by Cabinet, with redactions as appropriate under the Official Information Act 1982.

Recommendations

The Minister of Finance recommends that the Committee:

1 **note** that the Guardians of the New Zealand Superannuation (the Guardians) has requested a review of section 59 of the New Zealand Superannuation and Retirement Income Act 2001 (the NZSRI Act), which prohibits the New Zealand Superannuation Fund (NZSF) from holding a controlling interest in entities.

2 **note** that removal of the control restriction would provide strategic benefits to the NZSF, the Crown and the New Zealand economy through domestic investment opportunities and the potential for increased risk-adjusted returns for the NZSF.

3 **note** that by moving from minority to majority ownership, I do consider there is a heightened reputational risk for adverse business outcomes, but the Guardians have been independently reviewed to world class governance standards.

4 **note** that I consider the potential strategic benefits of relaxing the control restriction outweigh the original policy intent and that the removal of the control restriction is essentially a transfer of investment accountability from policy makers to the Board.

5 **agree** to the relaxation of the control restriction by amending the NZSRI Act.

6 **agree** that Guardians should be required to establish and maintain a new Statement of Investment Policies, Standards and Procedures for the selection and monitoring of controlling interests in entities.

7 **agree** to the development of an Amendment Bill to provide the amendments recommended above

8 **authorise** the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office for the amendments recommended above

9 **authorise** the Minister of Finance to make decisions on any further policy matters that arise as part of the implementation of the amendment recommended above, provided those decisions are consistent with the recommendations in this paper

10 **note** that a place on the 2022 Legislation Programme will be sought at the appropriate time

11 **agree** to the inclusion of the bill in the 2021 Legislation Programme, with a priority of category 5 (instructions to be provided to PCO in the year)

Authorised for lodgement

Hon Grant Robertson
Minister of Finance