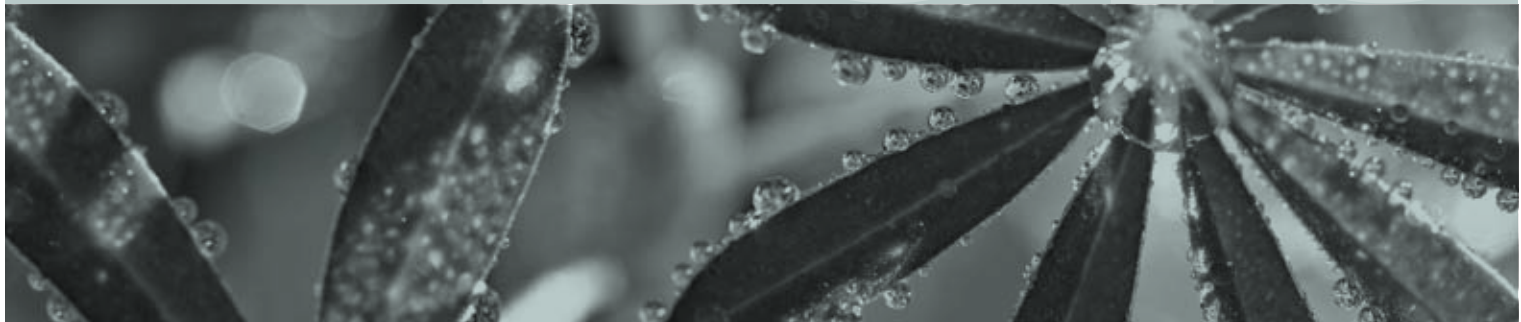


2010

REVIEW

JUNE 2010



CHAIRMAN'S LETTER



DEAR MEMBER

Each year we publish the Review to keep you informed about developments in the superannuation industry and NPF's activities for the last financial year.

The NPF schemes are unique in New Zealand in that payment of the benefits by the schemes is guaranteed by the Crown. This means members can be confident their retirement benefits are always secure. We mentioned last year that one NPF scheme had reached a position where it needed to call on the guarantee. This position is ongoing and from May 2009 the benefits payable by that scheme have been funded by the Crown, clearly demonstrating the advantage of having the guarantee in place. More detail is set out in that scheme's Annual Report.

NPF's investment performance is subject to the same external factors as other New Zealand superannuation schemes. The performance in the 2009 financial year was poor as a result of the Global Financial Crisis. In 2010, investment markets improved significantly. More information on how investment markets have performed is set out in the Investment Market Commentary. The investment results for your scheme are set out in the Annual Report enclosed with this Review.

CHANGE IN SCHEME ADMINISTRATOR

Effective 1 December 2009 the Board appointed Datacom Employer Services Limited (**Datacom**) as the scheme administrator for the NPF schemes. This follows the decision by the previous scheme administrator, Jacques Martin New Zealand Limited, to withdraw from the business of schemes administration.

Datacom is a subsidiary of Datacom Group, which is 30% owned by New Zealand Post and 70% owned by the staff and directors of the company. Datacom Group has annual revenues of approximately \$600 million, employs over 3,000 staff in New Zealand (in Auckland, Wellington and Christchurch) and another 700 in Australia and Asia.

REVIEW

Datacom has been carrying out the day to day administration of the schemes since 1 December 2009. The Board was pleased that they were able to employ almost all the administration and support staff from Jacques Martin who had worked on the NPF schemes for many years. The administration of the NPF schemes continues to be carried out using software owned by the Board.

The Board is also pleased that the transition from Jacques Martin to Datacom has been very smooth, with most members not noticing the change. For many members the only variation has been a change to the letter head for correspondence, which is a great result and something on which Datacom and the NPF administration and support staff are to be commended.

MISSING MEMBERS

The Board continues to devote resources to finding the large number of members for whom we do not hold a current address. All of the missing members are listed on the Board's website – www.npf.co.nz – click on Unclaimed Monies. If you have friends or family who may have been NPF members you should encourage them to check the website.

As noted last year, during 2009 the Board carried out a nationwide newspaper advertising programme inviting people to check the website if they believe they might have savings with NPF. Although the advertising campaign ended in June 2009, the Board continues to receive a steady stream of enquiries with approximately 30% of the application forms received being for people who have money with NPF.

I appeal to you to ensure you advise Datacom in writing of any change in your contact or bank account details. This will ensure you continue to have access to your savings and the number of missing members does not increase.

KIWISAVER – NPF'S LOCKED-IN SCHEMES

In response to the introduction of KiwiSaver, the Board established Locked-in sections for NPF's two largest defined contribution schemes, the Pension National Scheme and the Lump Sum National Scheme. The Locked-in sections have the following features:

1. an exemption from employer superannuation contribution tax (**ESCT**) on employer contributions up to 2% of gross salary or wages (provided those contributions are matched dollar for dollar by member contributions);
2. a tax credit on member contributions; and
3. compulsory employer contributions of 2% of gross salary.

In addition to the features outlined above, Locked-in section members receive the 4% minimum earnings rate, a hallmark of the NPF defined contribution schemes, and the protection of the Crown guarantee. The Crown guarantee is a unique feature of the NPF schemes.

The option to join the Locked-in section of the Pension National Scheme or the Lump Sum National Scheme is available to anyone who was a member of an NPF scheme as at 31 March 1991, subject to meeting the eligibility requirements. An Investment Statement can be obtained from Datacom.

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BOARD MATTERS

Each year the Board strategically reviews the future of the schemes and the issues facing NPF.

This year the focus was on the future of NPF over a 10 – 20 year time horizon and the impact of, and recovery from, the Global Financial Crisis on investment markets and investment returns.

As the NPF schemes are closed to new members the Board must plan on the basis the total membership will decline as contributors and pensioners leave the schemes.

The last 2 years have seen a slowdown in the decline in NPF membership, which we can speculate is due to the impact of the poor investment returns on retirement savings in 2009, the attractiveness of the minimum earnings rate for contributors and the Crown guarantee of benefits for all NPF members. However, this slowdown has little impact on the expected lifetime of the schemes and again the key finding of the strategic review is that NPF will continue to be a significant participant in the superannuation industry beyond 2020.

In line with international best practice governance of superannuation schemes, the Board has, since 1992, outsourced management for scheme administration, investment management, custody and advice. These arrangements continue to work well.

BOARD MEMBERSHIP

On 30 September 2009 Sue Sheldon retired as Chairman of the Board of Trustees and I was appointed in her place. In April 2010 Roy Tiffin's term of office came to an end and he also retired.

On behalf of the Board, I thank Sue and Roy for their contribution to NPF over the years and wish them well for the future.

TRIBUTES

The Board thanks the Management Team for their high level of support during the year and their commitment to the members of the NPF schemes.

I also record my thanks to my fellow Board members for their support and significant contributions to the work of the Board over the year.



Kind regards

Catherine Savage
Chairman
Board of Trustees of the National Provident Fund
30 June 2010

INVESTMENT MARKET COMMENTARY

A YEAR IN REVIEW

The NPF schemes are invested in a range of asset classes, as determined by the Board. Market commentary for the asset classes is outlined here. The specific asset allocation and investment performance of your scheme is explained in your Annual Report.

The theme of the past year has been one of improving investment returns and economic recovery following the Global Financial Crisis. In this environment, the returns from shares and global property have soared, while the more defensive asset classes, fixed interest and cash, have posted weaker returns on the back of the low interest rate environment globally.

NEW ZEALAND CASH

The Official Cash Rate (**OCR**), which is the base rate for overnight transactions with the Reserve Bank of New Zealand (**RBNZ**), largely influences the return on short term investments. Investors earn a 'premium' over the OCR for taking on repayment risk and for committing their funds for longer terms (such as 90 or 180 days).

After a further 25 basis points (**bps**) cut in April 2009, the RBNZ left the OCR at its record low of 2.5% over the year as the economic recovery remained fragile. This meant that returns from cash were fairly low at 2.92% as measured by the ANZ NZ 90 Day Bank Bill Gross Return Index. Looking ahead over the next year, the potential return on cash will continue to be low as RBNZ is not expected to start raising rates until at least June of this year.

FIXED INTEREST

Returns from fixed interest investments (such as Government stock and corporate bonds) are a combination of interest income and capital gains or losses as market yields fall (generating gains) or rise (generating losses).

Fixed interest returns from the Government sector were also modest for the year. While interest rates stayed at generally low levels, the improving risk appetite put upward pressure on market yields. In the key US market, the 10-year bond yield rose 116 bps over the year to 3.83%, while the UK rate was up 77 bps to 3.94%. In New Zealand, the 10 year bond yield ended the year 71 bps higher at 5.98%.

Value was added by fixed interest managers as the market yields for corporate bonds, compared to Government stock, declined during the year.

NEW ZEALAND SHARES

In line with the higher investor confidence, New Zealand shares performed well. The NZX 50 returned a strong 27.6% over the year. However, the market underperformed global shares due to its low 'beta' nature in this investment cycle – meaning that the New Zealand market tends to outperform global markets during sell-offs and underperform during rallies.

OVERSEAS SHARES

Returns from global share markets have surged over the past year reflecting the rise in risk appetite and the improving economic conditions. The leading measure of global shares, the MSCI Gross Index, returned 47.1% in local currencies for the year with all major markets posting strong returns. Emerging markets posted particularly strong results on the back of stronger growth. Returns for unhedged international equity investors were reduced due to the stronger New Zealand dollar but this was partly offset by the Board's foreign exchange hedging programme.

It has been a strong period for share markets since the lows of March 2009 and it would be optimistic to expect this to continue. The returns from share markets are likely to become volatile.

PROPERTY

The performance of the property sector is influenced by factors such as economic growth, business confidence, interest rates and vacancy levels.

The investment environment was favourable for listed property securities, both globally and in New Zealand, but direct property in New Zealand performed poorly, reflecting its lagging nature. The NZX Listed Property Index ended the year up 17.8% (according to the NZX Property Index), while the global stocks (as measured by the UBS Warburg Global Real Estate Investors Index) posted a return of 80.1% for the year in local currency terms.