



# 2009

## REVIEW

JUNE 2009

### 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 benefits are always secure. This year, one NPF scheme reached a position where it needed to call on the Crown guarantee. 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.

Your scheme's performance is subject to the same external factors as other New Zealand superannuation schemes. The results from investment markets in the last financial year were unprecedented. This is discussed in the section below on the Global Financial Crisis and in the Investment Market Commentary. The investment results for your scheme are set out in the Annual Report enclosed with this Review.

#### GLOBAL FINANCIAL CRISIS

The international financial system has been in crisis since the middle of 2007 with massive government interventions required to avert banking collapses, ensure liquidity and underwrite bad assets with taxpayer funds.

Despite a relatively sound banking system, New Zealand has been affected badly by the global financial crisis. Export demand is down and our commodity prices have fallen sharply. Although these effects have been cushioned by a fall in the New Zealand dollar, they add to the weakening of domestic demand caused by lower house prices and business incomes, and by rising unemployment.

The financial crisis has also hit retirement savings, setting back retirement for some and reducing superannuation balances. While bank deposits have been secure, large failures in the non-bank financial sector have also impacted investors badly.

Like many investors, both locally and internationally, NPF's investments have been severely impacted by the global financial crisis. However, the NPF schemes benefit from the Crown guarantee and members are therefore somewhat insulated from the worst affects of the crisis.



NATIONAL  
PROVIDENT

*In Safe Hands*

# CHAIRMAN'S LETTER

There were signs of improvement late in the financial year, notably a lift in share prices and some 'green shoots' in global economic activity. Nevertheless, the economic recovery is likely to be constrained and we will all continue to feel the impact of the crisis for some time to come.

Fuller details of how individual asset classes have fared over the last year can be found in the Investment Commentary.

## 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](http://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.

During the year, in addition to our dedicated search activities, we have carried out a nationwide newspaper advertising programme inviting people to check the website if they believe they might have savings with NPF. If their names are listed on the website people can download a form, complete it and send it to the schemes administrator, Jacques Martin. The Board is pleased with the results of this programme, with approximately 30% of the forms received being for people who have money with NPF.

I appeal to you to ensure you advise Jacques Martin 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. Contact Jacques Martin on 0800 628776.

## FUTURE OF SMALLER SCHEMES

Last year Management worked with the members of three of the smaller schemes, whose membership had declined significantly, to determine their future NPF membership. The work resulted in all members either electing to receive their benefit entitlements, or to transfer to another NPF scheme. Once the election and transfer processes were complete the schemes were left with no assets and no liabilities and they were wound up.

This work built on my comments in last year's Review where I wrote about the steady decline in the membership of the schemes. The decline is expected to continue until the number of members in each scheme, or the scheme's asset base, makes it uneconomic to manage the scheme as a stand alone entity. Before each scheme reaches this point the Board will develop a strategy to resolve the future of the scheme on a basis which is fair and equitable to all interested parties. The three schemes referred to above are good examples of the development and implementation of appropriate strategies.

It is interesting to note that over the last year the rate of decline of the NPF membership base has slowed. We can speculate that the reasons for this slowdown are the impact of the poor investment returns on retirement savings, the attractiveness of the minimum earnings rate for contributors and the Crown guarantee of benefits for all NPF members. "In Safe Hands" has proved to be particularly appropriate over the last 12 months.

## KIWISAVER – NPF'S LOCKED-IN SCHEMES

The Board has 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 superannuation contribution tax 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.

Membership numbers in the Locked-in schemes have not grown by as much as the Board had anticipated, despite their unique features. The earnings rate that will apply this year of 4% after tax and expenses will compare favourably with the investment returns earned by KiwiSaver schemes over the year.



The option to join an NPF Locked-in 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 Jacques Martin.

## BOARD MATTERS

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

This year the focus was on the future of NPF over a 10 – 20 year time horizon and the impact of the global financial crisis on investment markets and investment returns.

The review of the next 10 – 20 years was based on a model developed by Management that examined issues such as investment returns, costs of administration and the impact of different rates of withdrawal and mortality on scheme membership. While the model is a work-in-progress, and will be refined over the next 2 – 3 years, the key finding 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

In August 2008 the Minister appointed Paul Foley as a member of the Board. Paul is a partner in the Wellington office of legal firm Minter Ellison Rudd Watts specializing in corporate, securities and financial services work.

In April 2009 the Minister approved a short extension to my term as Chairman to 30 September 2009 and reappointed Roger Kerr as a member of the Board for a three year term to 31 May 2012.

The Minister also appointed Catherine Savage as a member of the Board and as Chairman-designate from 1 October 2009. Catherine has been involved in New Zealand investment management and private equity for over 17 years. She was Managing Director of AMP Capital Investors, one of the Board's investment managers, from 2000 to 2007. Catherine is a member of the Institute of Chartered Accountants.

We welcome Paul and Catherine as members of the Board.

## 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 and during my six years as Chairman.

As my appointment as Chairman ends on 30 September 2009, this is my last Review. I have much enjoyed my term as Chairman and the opportunity to make a contribution to what is now a fast growing industry. Although the NPF schemes are closed to new members, NPF is still an important participant in the New Zealand superannuation industry. We anticipate paying pensions to NPF members for another 30 years or so.

I wish NPF all the best for the future.

Kind regards.



Sue Sheldon CNZM  
Chairman  
Board of Trustees of the  
National Provident Fund  
24 June 2009

# 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 fallout from the US sub-prime mortgage debacle dominated the year and led to the worst financial crisis since the Great Depression. The crisis resulted in a collapse in share prices as appetite for risk evaporated and investors switched out of riskier assets into cash and government bonds. Policy makers turned their attention to rescuing the financial sector and reviving growth, with central banks cutting interest rate cuts on an unprecedented scale and governments implementing massive fiscal stimulus.

## NEW ZEALAND CASH

The Official Cash Rate (OCR) is the base rate for overnight transactions between banks and the Reserve Bank of New Zealand (RBNZ). It drives the return on short term interest bearing investments. Investors earn a 'premium' over the OCR for taking on repayment (i.e. credit) risk and for committing their funds for longer terms (such as 90 or 180 days).

The OCR was cut dramatically over the year from 8.25% to 3.00% as New Zealand was unable to escape the liquidity crisis and ensuing global recession. Returns from cash were relatively high, however, owing to the level of the OCR at the start of the period. Looking ahead, cash returns will be low as low interest rates are likely to persist for some time in this recessionary environment.

## 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 on existing debt securities) or rise (generating losses).

Fixed interest returns from the government sector were strong for the year as interest rates fell on the back of the global crisis creating capital gains for bond investors. In the key US market, the 10-year bond yield declined 75 basis points (bps) or 0.75% over the year to 2.66%. The corresponding UK yield fell 118 bps to 3.17%. In New Zealand, 10-year bond yields fell 113 bps to 5.27%. Investors in non-government securities, however, were impacted by the global credit crisis as the spread of corporate yields over governments widened on account of increased risk of defaults and a drain of liquidity from the market.

## NEW ZEALAND SHARES

The NZX 50 Index fell 24.1% over the year as investor confidence was undermined by the global economic downturn. But the market outperformed overseas shares due to its lower risk profile. The New Zealand market tends to outperform overseas markets during sell-offs and underperform during rallies because it has a low exposure to financial and resource stocks. Towards the end of the period share markets started reacting more positively to the large scale government fiscal responses.

## OVERSEAS SHARES

Overseas share markets were under severe pressure, reflecting the difficult period for the global economy and earnings environment ahead. The leading measure of global shares, the MSCI World Gross Index, ended the period down 37.0% in local currencies with all major markets posting large negative returns. Unhedged international equity investors were helped to some degree by a fall in the New Zealand dollar with the MSCI Index returning -20.9% in New Zealand dollar terms. In March, shares rallied with an improvement to the tone of economic data. Although share prices look attractive from a long-term perspective, offering yields far above those on cash and bonds, there is considerable uncertainty about companies' ability to weather the financial storm and sharply slower growth. The massive global fiscal and monetary easing should result in a global economic upturn through 2010 and shares were anticipating some improvement as the financial year ended. It remains to be seen whether this rally persists.

## PROPERTY

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

The slowing economy and negative investor sentiment also weighed heavily on the listed property market over the period. The NZX Listed Property Index ended the year down 20.3%, while the global property shares (as measured by the UBS Warburg Global Real Estate Investors Index) posted a massive -54.8% decline in local currency terms. These share price declines anticipate lower underlying property valuations to come and, in many cases, discounted new equity issues as companies are forced to refinance debt. New Zealand vacancy rates remained low but there remained a lack of transaction activity and capitalisation rates continued to rise. Moreover, tighter lending standards and rising funding costs reflecting a perceived increase in risk meant that highly leveraged asset classes, such as property, were especially hard hit.

The outlook for the property sector remains weak. The deep economic slowdown is expected to drive vacancy rates higher and rents lower and valuations will continue to fall in this environment.