

**Presentation to:
Asset Allocation Summit
20 July 2009**

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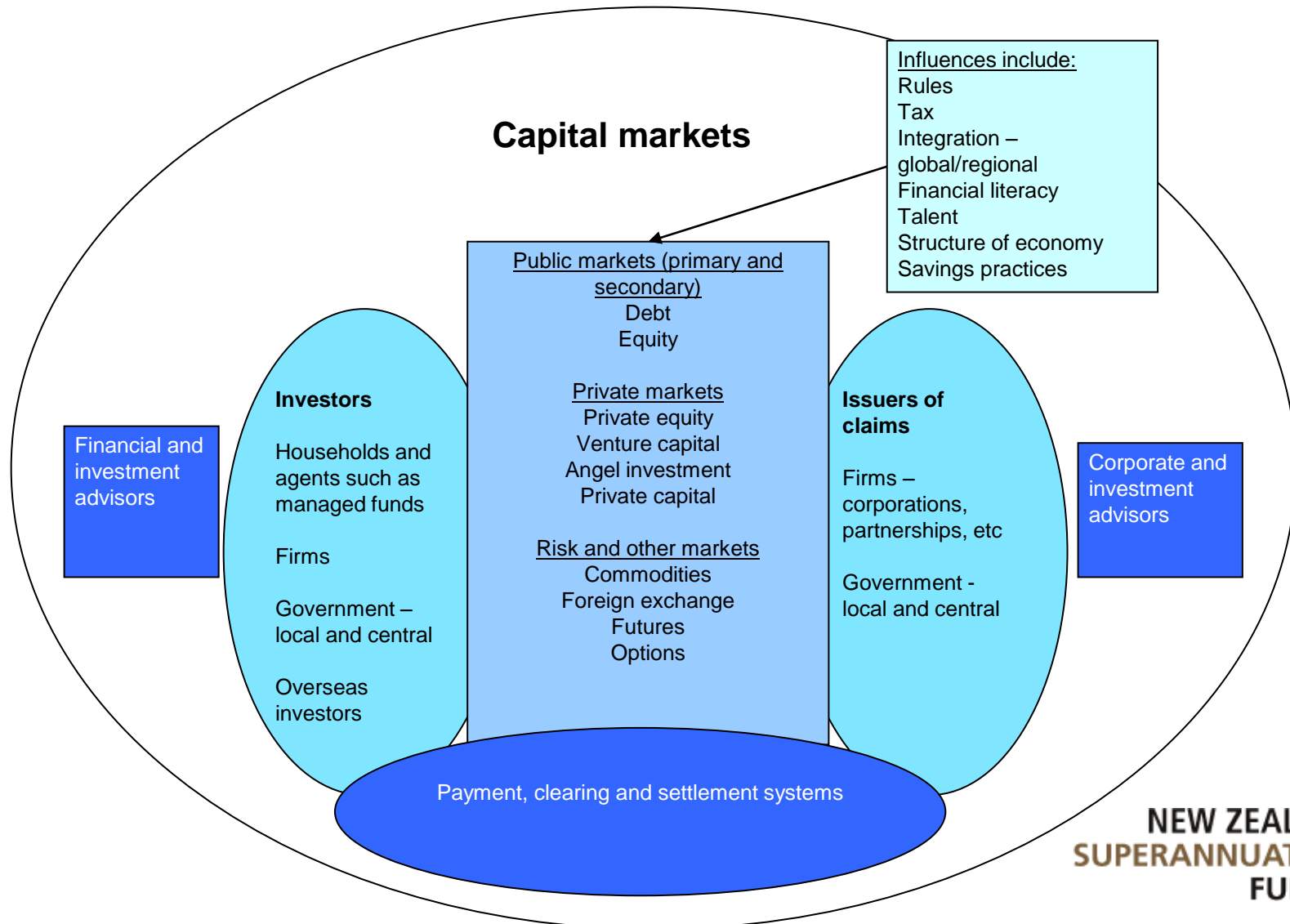
Topics

- What do capital markets do?
- What are the unique features and issues?
- The Capital Market Development Taskforce
- The role of New Zealand Superannuation Fund

What capital markets do and why they matter?

- A range of functions in the economy:
 - Facilitate the flow of household savings to capital investment by firms and others
 - Provide risk pooling and risk sharing opportunities
 - Allow management and risk bearing to be separated
 - Provide information and prices to inform saving and investment decisions

What capital markets do and why they matter?



What capital markets do and why they matter?

- We want our capital markets to be sound and efficient
 - Efficient markets allocate capital and risk appropriately without undue transactions costs
 - Sound markets are resilient to a range of adverse circumstances
 - Markets will deviate from the efficient risk/return line at times, but in a sound market they will return to “equilibrium”
- Well functioning capital markets enable the various types of financial risk to be adequately:
 - Identified
 - Priced
 - Allocated to those best able to
 - Manage the risk

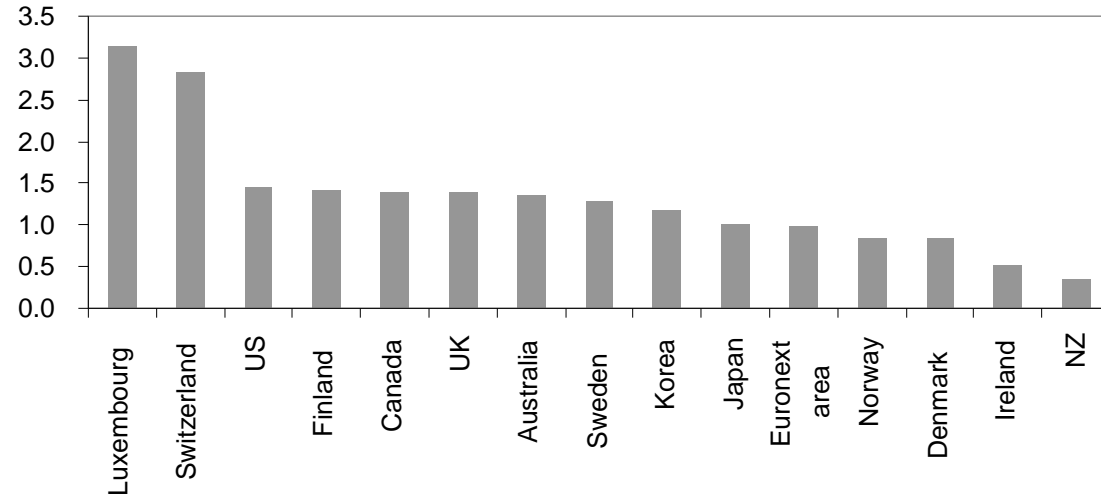
What capital markets do and why they matter?

- If these markets don't work well:
 - Individuals are unable to make appropriate savings and investment decisions
 - E.g. individual's retirement income may be reduced or subject to greater volatility
 - Firms are unable to manage balance sheets effectively
 - Fewer options to mitigate business risks
 - May be more likely to move to other locations to access better functioning capital markets
 - Financial vulnerability and poor economic performance

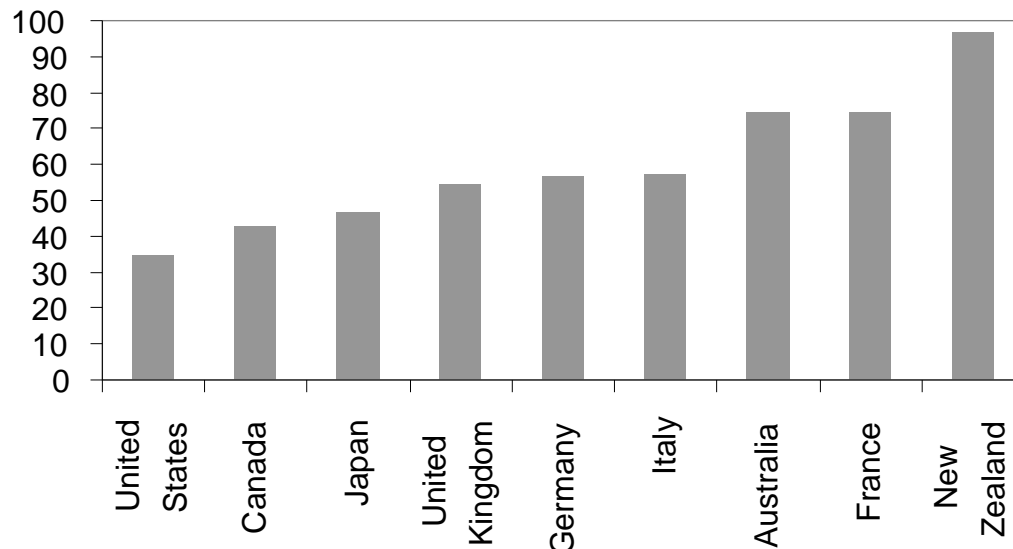
What do our capital markets look like?

- Bank dominated
- Households love housing assets
- Listed equities market small

Equity market capitalisation, 2007 (ratio to GDP)



Net wealth in housing, 2007 (percent)



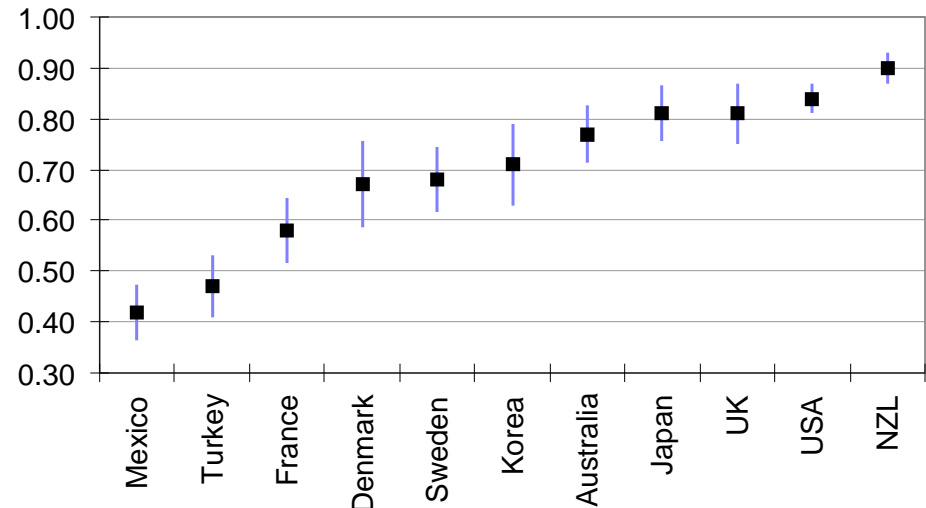
What do our capital markets look like?

- Product gaps (or limited availability in some areas), e.g.
 - Futures and other derivatives, e.g. for commodities
 - Annuities
 - Long-term government bonds
- Financial advisor integrity difficult to assess
- High levels of integration with capital markets in other countries

What do our capital markets look like?

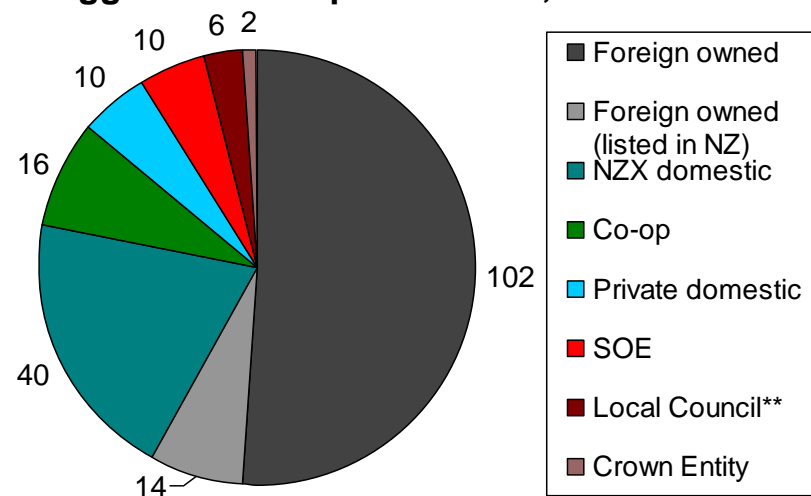
- Despite “good” regulatory settings, limited activity occurs
- Partly explained by structure and size of economy
 - Foreign and government ownership of many of our largest firms
 - Agriculture dominated by individual producers and co-ops
 - Relatively few global-scale companies

OECD index of securities market regulation strength



Source: OECD Economic Policy Reforms, Going for Growth, 2006 Edition.

Biggest 200 Companies in NZ, Dec 08



What do our capital markets look like?

- The regulatory environment is complex, consisting of multiple rule makers and enforcers
 - RBNZ, MED (incl Companies Office), Securities Commission, NZX, Trustees and industry ombudsman all have roles
 - Roles are not always clearly delineated and there appears to be both overlaps and gaps
 - Purpose of regulatory roles differs
 - Consumer protection, managing systemic risks, enforcement, ensuring market integrity, etc
 - Metrics of success are not clear
 - No failure? Efficiency??

How are we approaching our work?

- Building a picture of our capital markets as they are, and why they are that way
- Developing a framework for what well functioning markets would look like
- Looking at issues from multiple perspectives:
 - Investor perspective
 - Issuer perspective
 - Regulatory settings
 - Tax issues that impinge on markets
 - Market infrastructure needs
 - Opportunities for NZ's capital markets to capture share of international financial services business
- We have sub-groups working on these issues

How are we approaching our work?

Regulation:

- A good game is made by good rules – not by good players
- Discipline = self, market, regulatory
- Regulation should be necessary (benefit-cost):
 - be easy to understand
 - be competitively neutral
 - encourage productive and creative behaviour
 - discourage “gaming” activity
 - rely on individual and market discipline to the extent possible
- A good game also requires a well qualified neutral referee – a regulator who enforces the rules consistently and has the confidence and respect of market participants

How are we approaching our work?

- NZ has some real strengths to build on
 - Low levels of corruption
 - NZers are perceived as honest and fair
 - Sound regulatory system in general – although some scope for improvement
 - Skilled and educated workforce – including good language skills
 - Time zone...
- We believe that we can build a really good regulatory system that is fit for purpose for New Zealand and its companies, and which will allow our capital markets to build on our strengths and be a source of competitive advantage

Achievements to date

- November 2008 Interim Report responding to the crisis and the need for firms to recapitalise
 - Legislation in response to report now in Parliament
 - New NZX listing rules in place and consultation on changes to Securities Regulations
- Wide range of background studies to be published in coming weeks

Work programme going forward

- A progress report due this month will:
 - Set out framework
 - Provide initial ideas on improving markets from the perspective of investors
 - Complete our earlier capital raising for smaller companies
- Background research will be released as we complete it. Report topics include:
 - NZers' savings practices
 - Structure and ownership of the economy
 - Talent in capital markets
 - Extent of integration of our capital markets with those in other countries
 - Financial literacy, including a comparison to other countries
 - Why capital markets matter
- Final report – due to be completed December 2009

Role of the New Zealand Superannuation Fund

Our purpose is to help future Governments to meet the future tax cost of New Zealand Superannuation

- First draw-downs in 2031, the bulk of them long afterwards
- That's you, your kids, your grandkids and New Zealanders not yet born

Role of the New Zealand Superannuation Fund

We would look at

- Rural and land based investment
- Investments with State owned Enterprises
- Private market assets
- Infrastructure
- Recapitalisation and expansion

Practicalities we must keep in mind

- Serving our purpose
- Liquidity
- Price taking
- Market making
- Concentration of risk
- Conflicts
- Instruments available

We will have a big and growing role in NZ capital market