Inquiry into the Debt Retirement Fund

NSW TREASURY

SUPPLEMENTARY QUESTIONS

Response due: Wednesday, 2 August 2023

QUESTION 1

Please provide the Risk Appetite Statement relevant to TCorp's management of the NSW Generations Fund (NGF) / Debt Retirement Fund (DRF) for each of the Financial Years since 2015-16.

ANSWER

The DRF was established in November 2018. The Risk Appetite Statements (RAS) for the DRF were developed in conjunction with TCorp, endorsed by Treasury's Asset and Liability Committee and then approved by the Treasurer or the delegate of the Treasurer. Please refer to **Attachment A** for the requested information. The RAS was last reviewed and approved (by the Secretary as the Treasurer's delegate) in March 2021.

QUESTION 2

What is the amount of money paid to TCorp in fees in relation to the management of the NSW Generations Fund / Debt Retirement Fund for each of the Financial Years since inception of the NGF.

ANSWER

The table below is a summary of the NGF's audited annual financial accounts since inception (16 November 2018) to 30 June 2022 (the last available financial statements). It sets out TCorp's fees in relation to the management of the NGF.

As shown in the table below, TCorp's advisory/trustee fee is approximately 0.04 per cent per annum, representing 3 per cent of TCorp's net income. TCorp is wholly owned by the NSW Government and profits are returned to the State through dividends.

Category	30 June 22	30 June 21	30 June 20	30 June 19
Expense recovery fees[1]	$110,445	$102,500	$93,958	$28,925
Management fees[2] / Trustee fees[3]	$6,130,736	$5,635,159	$5,191,003	-

1. TCorp, as the Trustee, incurs certain expenses for services provided to the NGF. To cover these expenses, the Trustee is entitled to receive expense recovery fees.

2. Management fees are earned where portfolio management services are provided for specific assets or asset classes beyond the role performed as Trustee.

3. Trustee fees represents fees payable for performing the role as Trustee which includes investment management and advisory services.

QUESTION 3

What is the amount of money paid to third parties in fees in relation to funds under management in the NSW Generations Fund / Debt Retirement Fund for each of the Financial Years since inception of the NGF.

ANSWER

Investment fees

The NGF, alongside other NSW government entities, mostly invests via other investment trusts each with holdings in different asset classes in line with the NGF's investment objective. The NGF does not directly pay fees to investment managers. Rather, it receives a 'net of expenses' investment return from each of several TCorp investment trusts that it invests in (alongside other government entities). These investment trusts each have holdings in different asset classes. The largest expense within each of these TCorp investment trusts relates to external investment managers, and the investment manager fees vary materially depending on the asset class under management.

TCorp estimates that the NGF's share of these investment manager expenses (excluding TCorp) has been approximately 0.30 per cent per annum of the fund's balance since inception. The quantum of investment manager fees changes each year with changes in the value of investments and in line with changes in the asset classes held by the NGF.

The performance of the NGF net of all investment fees (including TCorp's) is approximately 6.5 per cent per annum since inception. This represents almost $4 billion of investment revenue since inception in 2018 (noting that this figure does not consider any implied borrowing costs).

Other fees

For 2022-23, there is also an internal audit fee payable of $39,760 to Deloitte.

QUESTION 4

In Treasury's submission, it identifies three metrics to consider for further contributions to the DRF - Net Lending/Borrowing, Budget Result or Net Cash Operating Balance. Which of these three metrics does Treasury recommend the Government adopt?

ANSWER

How much and when to contribute is a policy decision for Government and will depend on the risk appetite of the State and how the State operationally defines the threshold for making contributions.

Treasury recommend a holistic approach that considers thresholds for financial metrics that are common across Australian States and comparable international peers, the size and growth of gross debt and Government's policy objectives. Treasury's advice will be provided to Government as part of the 2023-24 September budget process.

Treasury noted the three metrics (Net Lending/Borrowing, Budget Result and Net Cash Operating Balance) that were considered by PJP in their report.

Treasury recommend that the metric selected should create a cap on contributions made, and that any budget result metric be calculated after removing the net impacts of the DRF.

Treasury noted that the State's fiscal position and the economic environment have changed materially since the COVID pandemic, which suggests it is appropriate to consider the adoption of a more conservative approach to contributions into the DRF.

QUESTION 5

Does Coolabah Capital Investments own or invest in TCorp-issued bonds?

ANSWER

Treasury does not have visibility over the investments of Coolabah Capital.

Link Market Services is TCorp's registrar and is responsible for maintaining TCorp's bond register. The register of bond holders is confidential.

QUESTION 6

Has Treasury been directed or requested to prepare any briefing notes or memos Treasury that includes references to changes to the NSW Generations Fund Act 2018 or any other legislation that would affect the Debt Retirement Fund?

ANSWER

Treasury has not been directed or requested by the current Government to prepare any briefing notes or memos that reference changes to the NGF Act or any other legislation that would affect the DRF.

QUESTION 7

Is any work underway within Treasury that would involve changes to the NSW Generations Fund Act 2018 or any other legislation that would affect the Debt Retirement Fund?

ANSWER

There is no work currently underway within Treasury to amend the NGF Act, nor the Fiscal Responsibility Act 2012 (FRA), which is referenced in section 8 of the NGF Act.

QUESTION 8

Please provide a list of all payments into the Debt Retirement Fund and out of the Debt Retirement Fund by date, specifying the nature of each payment.

ANSWER

The following is a list of cash payments into, and out of, the NGF:

From the **audited and published NGF annual reports.**

Financial year	Amount ('000)	Description
2018-19	$8,900,000	Government contribution
2018-19	$1,080,972	Distributions from State's investment in WestConnex
2018-19	$7,102	Interest earned
2018-19	$1	GST received
2019-20	$0	Government contribution
2019-20	$117,790	Distributions from State's investment in WestConnex
2019-20	$727	Interest earned
2019-20	$296,000	Windfall tax revenue
2019-20	-$11	Administrative expenses - Auditor's remuneration
2020-21	$1,932,284	Government contribution
2020-21	$95,000	Distributions from State's investment in Roads Retained Interest Pty Ltd
2020-21	$2,289	Interest earned
2020-21	$1	GST received
2020-21	-$16	Administrative expenses - Auditor's remuneration
2021-22	$0	Government contribution
2021-22	$684,099	Distributions

2021-22	$10,288,529	Proceeds of sale of WestConnex
2021-22	$48,693	Interest earned
2021-22	$1	GST received
2021-22	-$7,660,762	Repayment of State Debt
2021-22	-$13	Administrative expenses

During the financial year 2021-22, no cash contributions were made to the NSW Generations via appropriation.

From the **unaudited draft NGF annual reports**.

2022-23	$0	Government contribution
2022-23	$	Distributions
2022-23	$98,158	Interest earned
2022-23	$2	GST received
2022-23	-$3,339,238	Repayment of State Debt
2022-23	-$16	Administrative expenses

During the financial year 2022-23, no cash contributions were made to the NSW Generations via appropriation.

Final figures will be available in the audited and published NGF annual report.

QUESTION 9

Who can authorise a payment into the Debt Retirement Fund and under what circumstances?

ANSWER

Section 9 of NGF Act gives the Treasurer authority for certain monies (e.g., distributions and sale proceeds of equity interests, DRF investment returns) to be paid into the DRF.

Payments to the DRF can also be authorised through appropriations by Parliament, advances by the Treasurer, or directions by the Treasurer, if the Treasurer is satisfied that the payment is a windfall tax revenue.

Attachment

A – Risk Appetite Statements

Attachment A – Risk Appetite Statements

Please note:

- CPI refers to the Consumer Price Index.
- VaR refers to Value at Risk.
- CVaR refers to Conditional Value at Risk.

NGF investment objective and risk appetite approved on 5 July 2018 by the Treasurer

Investment objective and risk appetite	Measure
Investment Objective	CPI+4.5 per cent per annum over rolling 10-year periods
Frequency of negative returns	No worse than 1 in 4.2 years

NGF investment objective and risk appetite approved on 11 December 2019 by the Treasurer

Investment objective and risk appetite	Measure
Investment Objective	CPI+4.5 per cent per annum over rolling 10-year periods
Rolling 3-year 5% VaR (cumulative)	No worse than -6.2 per cent
Frequency of negative returns	No worse than 1 in 4.2 years

NGF Risk Appetite Statement approved on 17 March 2021 by the Treasury Secretary

Category	Context	Measures	Current Priority Very High / High / Medium / Low
Mission: Return Objective	The return objective is annualised and measured over the Fund's investment horizon.	**Target Return**: To achieve a return above CPI of 4.5% per annum (net) over 10 years. **Return Probability**: Minimum probability of 50% of achieving the return objective. **Tax Status**: Exempt from Australian income tax. Does not receive franking credits.	Very High
Mission: Debt Offset	Maximising the assets of the Fund, which qualify as a debt offset is an important objective. Credit rating agency treatment given to assets is not transparent and may change from time to time.	**Debt Offset Treatment**: Consideration should be given to credit rating agency debt offset treatment when structuring of investments, based on best available information.	High
Mission: Distribution Volatility	Annual distribution from the Fund are counted as General Revenue of the State.	**Distribution Volatility**: A smoother sequence of annual distributions is preferred. The NGF Trust is classified as an Attribution Managed Investment Trust (AMIT) for taxation purposes, which enables a smoother flow of annual distributions.	Low

Investment Risk: **Volatility**	To achieve the Fund's long-term mission the Fund needs to assume risk.	**Expected Volatility Range**: The annualised standard deviation of the Fund is expected to range between 5.5-10.5%.	Low
Drawdown Risk: **Frequency of Negative Returns**	To support the Fund's long-term mission annual negative returns are probable. The Fund has a high tolerance for negative returns on an annual basis.	**Expected Frequency:** No worse expected frequency of annual negative returns than 1 in every 4.2 years.	Low
Drawdown Risk: **Negative Return**	The Fund should have a clearly defined tolerance for the magnitude of expected negative returns.	**Expected Fund CVaR (3 years):** The Fund's CVaR (5%) as measured over rolling 3 year periods should not be worse than -8.0% per annum. **Expected Fund CVaR (1 year):** The Fund's CVaR (5%) as measured over 1 year should not be worse than -18.5%. **Expected Fund VaR (3 years):** The Fund's VaR (5%) as measured over rolling 3 year periods should not be worse than -2% per annum.	High Medium For information only
Drawdown Risk: **Time to Recovery**	The Fund should have clear expectations for time to recovery for a given tail loss.	**Expected Time to Recovery:** Following a drawdown, consistent with a 5% 1 year CVaR, it is expected that the time to recovery will be on average 5 to 6 years.	Low

Liquidity Budget	The Fund has a high tolerance for liquidity risk.	**Liquidity Expectations:** Normal Market Environments: • 60% available within 6 months. • 80% available within 1 year Stressed Market Environments[1]: • 50% available within 6 months. • 60% available within 1 year.	Low

[1] Stressed environments are classified as liquidity events for risk assets. Stressed environments are expected to occur every 1 in 20 years.