IN THE WAITANGI TRIBUNAL | WAI 2490

IN THE MATTER OF The Treaty of Waitangi Act 1975

AND

IN THE MATTER OF the Ngapuhi Mandate Inquiry

BRIEF OF EVIDENCE OF DR JOHN YEABSLEY

19 November 2014

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Introduction

1. My full name is John Yeabsley.

2. I am a Senior Fellow of the New Zealand Institute of Economic Research (NZIER), an independent economic research agency, in Wellington.

3. I hold the following qualifications: degrees in mathematics and philosophy and a Masters degree with first class honours in economics, all from the University of Canterbury. In addition, I have a Ph.D. in economics from the University of Essex.

4. I spent twenty-five years with the public sector, largely as an economic policy advisor, working in a range of Departments and for a succession of governments. Positions held included Director of Economics and Assistant Secretary in the Department of Trade and Industry, and Chief Labour Market Advisor and General Manager with the Department of Labour. Much of my experience was involved with assessing policy, particularly from the viewpoint of national benefit.

5. Since then I have been at the NZIER where from 1994 to 1996 I was the Chief Executive undertaking the usual roles associated with such a position.

6. At NZIER I have undertaken a number of research and economic consulting tasks over the last 20 years. These include work for both the public and private sector.

7. I have given evidence to the Waitangi Tribunal on several occasions including in connection with:

   7.1 the Wai 776 2 GHz claim;

   7.2 the Wai 796 petroleum claim;

   7.3 the Wai 1071 foreshore and seabed, where I was commissioned by the Tribunal to give evidence; and

   7.4 the Wai 45 Ngati Kahu remedies inquiry.

8. I have also prepared material for the Tribunal in connection with technical evidence relating to a forestry claim.

9. I confirm that I have read the Code of Conduct for Expert Witnesses contained in Schedule 4 of the High Court Rules and I agree to comply with it in giving my evidence.

The purpose of this brief

10. I have been asked to address an issue that I understand is relevant to the Tribunal's inquiry into claims concerning the mandate of Tuhoronuku to represent all Ngapuhi in Treaty settlement negotiations with the Crown.

11. The issue is whether there are economic advantages to Ngapuhi in entering settlement negotiations leading towards a single Ngapuhi settlement as opposed to groups within Ngapuhi entering five separate Treaty settlement negotiations leading towards five separate Treaty settlements.

Introduction

12. This note therefore is to discuss potential economic effects of Ngapuhi receiving the cash element of their settlement as a single sum or separating the settlement into several separate pieces. In any Treaty settlement, there is a range of redress: land, cash and other forms of redress (eg a Crown apology, an account of the relevant history, Crown acknowledges and concessions of treaty breach, protocols with departments amongst other things). My analysis is restricted to the fiscal element of the settlement. I do not address the other elements of any settlement.

13. I note that the total monetary value of any settlement is the sum of the worth of its components: land plus cash. I am only dealing with the cash component.

14. For this analysis I make the following assumptions:

    14.1 the options are a single settlement with a cash component of $100 million or five separate settlements each with a separate cash component of $20 million; and

    14.2 accepting a single settlement or five separate settlements will not affect the total settlement offered by the Crown.

15. I must be clear the figure of $100 million is a purely hypothetical assumption. I do not know what the total value of any actual Ngapuhi settlement would be, let alone what the parties would negotiate the cash element of it to be. The actual cash element could be more or less than $100 million. I do not want to

be misconstrued as saying a Ngapuhi settlement will be $100 million; that is not what I am saying. I am using the figure of $100 million simply to explore the implications of the alternatives.

16. In assessing the impact I consider both potential drivers of returns on the invested fund and the needs for decision-making on both the investments made by the fund, and on the distribution of income received by the fund to iwi and hapu. My assessment has been informed by, standard portfolio investment theory, a review of the literature on fund management performance drivers and costs, and discussions with local investment managers. I have also reviewed the settlement history and I start with what I found there.

What does the record show?

17. A detailed comparison of the asset diversification opportunities and potential economies of scale depends on the particular investment portfolio. To illustrate this point we have used annual reports published by four iwi to calculate an estimate of the investment returns achieved by the following four iwi over the past five years::

    17.1 **Ngai Tahu** which received a settlement of $170 million in 1998, apparently[1] followed by further settlements totalling $130 million over the period 2007 to 2014. These funds are managed by Ngai Tahu Group Holdings.

    17.2 **Waikato-Tainui (Tainui)** which received a settlement of $170 million in 1995. These funds are managed by Tainui Group Holdings.

    17.3 **Ngāti Awa** which received a settlement of $42 million in 2005 and which appeared to add to a pool of about $40 million assets already held by Ngati Awa.

    17.4 **Ngaa Rauru Kiitahi** which received a settlement of $31 million in 2005.

    These estimates are based on our interpretation of financial reports published by each iwi. As the reporting formats used by these iwi have changed gradually over time and there are also minor differences between the reporting format used by each iwi the estimates are suitable for broad comparisons of returns only.

[1] Based on analysis of the Ngai Tahu Holdings annual reports on the balance for "Trust Funds in Perpetuity"

18. The purpose of the examples is to illustrate the investment management options for five portfolios of $20 million compared to one portfolio of $100 million. Accordingly, I selected a sample of settlements greater than $30 million where the settlement legislation had been passed more than seven years ago (to allow time for an investment approach to be established) and where annual reports on the management of the settlement assets were publicly available. I identified six of the 51 settlements listed on the Office of Treaty Settlements website which met the settlement amount and date of legislation criteria. Of these two were excluded for the following reasons:

    18.1 "Commercial Fisheries" as I understand this settlement was subsequently distributed to iwi as shares in Aotearoa Fisheries Limited and fishing quota.

    18.2 Ngāti Ruanui as I could not find a series of annual reports for this iwi.

19. I compared the returns earned on the funds settled over the most recent five years as well as the investment approach used by the funds. What I have found broadly from the review can be summarised as the following:

    19.1 The larger settlements have tended to deliver better returns on equity than the smaller settlements. In particular:

        19.1.1 Ngai Tahu earned an average profit from trading operations of 7.8 percent of equity over the five years 2010 to 2014 and increased their equity at a compound annual growth rate of 13.5 percent over the same period. (Most of the difference between the two rates of return is explained by asset revaluations).

        19.1.2 Tainui earned an average profit from trading operations of 5.2 percent of equity over the five years 2009 to 2013 and increased their equity at a compound annual growth rate of 4.4 percent[2] over the same period.

        19.1.3 Ngati Awa earned an average profit from trading operations of 1.2 percent of equity over the five years 2008 to 2012 and increased their equity at a compound annual growth rate of 2.9 percent over the same period.

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2 For the calculation of the compound annual growth rate in equity we have treated the increase in issued share capital as if it was new money raised from the iwi.

19.1.4 Ngaa Rauru Kiitahi earned an average return of 4.4 percent of equity over the five years 2008 to 2012 and increased their equity at a compound annual growth rate of 1.1 percent over the same period.

19.2 The larger settlements allow iwi to be successful active investors while the smaller settlements appear to be invested in more diversified portfolios. In particular:

19.2.1 About 50 percent of Ngai Tahu's funds are invested in commercial residential and rural property. (Over the past three years Ngai Tahu has increased the proportion invested in farm property and reduced the proportion invested in commercial and residential property.) Although about 20 percent of Ngai Tahu funds are invested in shares, the share portfolio includes a small number of selected stocks rather than a diversified portfolio.

19.2.2 Tainui has almost 80 percent of its funds invested in commercial and residential property and operates both as an investor and a property developer.

19.2.3 Ngati Awa has approximately 35 percent of its funds invested in cash, bonds and unit trusts, 5 percent of its funds invested in unlisted shares in Aotearoa Fisheries Limited and Fonterra shares, 37 percent invested in property (commercial, residential and rural), a further 18 percent in forestry assets and about 3 percent in fishing quota.

19.2.4 Ngaa Rauru Kiitahi has invested its funds in managed funds with approximately 50 percent of the funds in cash or fixed interest and the remainder spread over global equities, private equities and infrastructure funds and hedge strategies.

20. While there is no assurance of cause and effect, given this is a selective sample, and small numbers at that, I see these findings as showing the effects that can be associated with scale.

21. So the larger settlements have tended to be "active" investors. And the return side advantage of being active, comes from being able to take equity positions

and thus avoid fees, plus reap all the rewards of value accrual (as well as the flows of earnings). But this style of investment demands that the investor take positions in the unit size they are when they surface on the market. In theory, say farms and fishing ventures, to name several areas of interest, might be able to be equity accessed in less than whole blocks, but to do so requires the existence and accessibility of suitable (low cost) ownership vehicles. As a matter of fact these seem scarce.

22. This means the investor faces the issue of being able to fund a spectrum of holdings of sufficient diversity to approach an efficient portfolio.[3] Without it the risks of the holdings will, at least in principle, be higher than market risk for their return. In short, there are practical difficulties for smaller investment amounts (such as the $20 million funds envisaged here) of accessing an efficient portfolio, if they are active investors. This might pose problems for the beneficiaries.

Decisions – what needs to be done?

23. Essentially the returns from the settlement investment and the extent to which it can be used to create an inter-generational economic base will depend on trustee-style decisions on the following questions:

    23.1 approach taken to monitoring and reporting the investment of settlement funds to iwi and hapu;

    23.2 performance of the assets in which the settlement is invested; and

    23.3 balance between distribution of earnings from the fund as opposed to reinvestment in the fund.

24. The central question[4] is whether and how the size of an investment pool of $100 million versus five of $20 million would potentially affect the returns from the investments and the potential growth path of the investment. In other words, are there significant economies of scale in the results of the decisions and other aspects of the operation that would suggest higher

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3 An efficient market portfolio is one that achieves the best combination of risk and return by diversification of holdings within the available market offerings.

4 A potential secondary question is the shape of the likely spread of returns across the five $20 million funds and whether this is likely add a layer of comparison analysis and related cost that would not be present for the $100 million portfolio; it also could create pressure for short-term changes in investment management and strategy.

economic value to Ngapuhi as a whole from a $100 million portfolio as opposed to five $20 million portfolios.

25. For the sake of clarity I define two types of trustee decision-making and processes:

25.1 hapu relationships and accountability that include:

25.1.1 setting the objectives for the returns from the fund – reaching a consensus on aspirations and balancing this against what can be achieved at acceptable risk

25.1.2 allocation of income earned from the assets between distribution and re-investment

25.1.3 process of reporting to and consulting with hapu about the performance of the investment.

25.2 investment management decisions which relate to:

25.2.1 allocation of funds to particular types of investment and rebalancing of those investment allocations over time as the values change

25.2.2 where the investment portfolio is positioned on a continuum from passive and managed by third party, to fully active where the trustees act as in-house investment managers.

Investment management – active investor

26. The mix of "active" investments chosen by both Ngai Tahu Group Holdings and Tainui Group Holdings includes substantial investment in local property assets and resource-based outfits such as their own fisheries assets.

27. This is in contrast to a "passive" approach whereby the settlement trustees invest the settlement more or less as if it were to be a pension or managed fund, delegating the choice of investment assets to a fund manager. Under this model it is highly unlikely that any of the funds would be invested in local business or non-financial assets within the local area. Rather the portfolio model would achieve risk management and balance by purchasing shares in existing investment pools that have appropriate scale.

28. Once established as active investors, the two examples also seem to have recently grown at rates greater than the more passive funds. Indeed, my review of the relatively few settlements that are more of the size of the $20 million ones under examination, suggests they have been cautious with their approaches starting with a 'diversified' managed funds investment pattern, and only latterly seeking out more narrowly based but actively managed investments, like farms.

29. I see these larger long standing precedents – Tainui and Ngai Tahu - as likely to "set the bar" for the more numerous member but probably similar scale settlement to Ngapuhi. It seems probable that Ngapuhi will have aspirations informed by the success of those two settlements.

Hapu relationships and accountability

30. A pre-requisite for stable investment decision-making is the separation of the decisions about the objectives for the fund and distribution of investment earnings from the investment management, and the selection of assets. Gaining consensus on how the investment fund will be used and securing commitment to that strategy requires trustees with paramount leadership and mana to gain and maintain commitment to an agreed strategy. To the extent that mana and leadership are hierarchical qualities we would argue that a single investment fund of $100 million is likely to have a larger talent pool to draw from, thereby be able to select more talented trustees, and be able to make more efficient use of their skills than if the same aggregate talent pool is spread across five funds attempting to answer similar questions[5].

31. The potential difference in leadership performance for larger and smaller funds is due to the potential difference in the quality of governance and management that can be accessed by the fund rather than a pure economic argument and is difficult to quantify. I cannot provide a measurement estimate of the difference but I suggest that it is a material factor in the potential achievement of the claimants' financial objectives from the settlement.

32. At a more mundane level, reporting back to hapu on the performance of the fund and consultation on future strategy incurs common fixed costs such as registration and accounting systems, development of communications and

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5 To state the point in terms of an example, every fund needs a CEO; finding one outstanding individual is easier than finding five.

plans etc. To the extent that the requirements for each of the five funds are similar, most of these multiple fixed costs could be avoided by a single fund.

33. My sense is that there are:

33.1 modest differences in performance in the decision-making by the trustees on the distribution of returns and the small economies of scale in the monitoring and reporting investment returns to iwi and hapu that apply irrespective of the investment management approach; and

33.2 potentially significant economies of scale from a $100 million portfolio compared with a $20 million portfolio the more the trustees move toward an active rather than a passive investment strategy. (An important caveat on this observation is that as trustees opt for a more active investment approach they are likely to move away from an efficient market portfolio.)

34. All this means we can say that to the extent that the claimants want to adopt an active investment strategy that is focused on direct ownership of a particular type of asset, which has been the model followed by those managing large Treaty settlement assets to date, a single $100 million fund is much more likely than the five $20 million funds, to be able to:

34.1 attract the level of expertise necessary; and

34.2 build a diversified portfolio of these assets.

Passive investment management decisions – starting point

35. For completeness, I now discuss passive investment approaches. I need to caveat this section by saying that from my review, investment strategies for large Treaty settlements have not typically followed a passive investment approach.

36. The starting point for investment management and asset allocation decisions is the drafting of a Statement of Investment Performance and Objectives (SIPO). A SIPO sets out the expected allocation (usually expressed as a range) of assets between asset classes such as cash fixed interest, New Zealand equities, overseas equities and may also cover other decision points such as the use of hedging against foreign exchange risk etc. These documents are typically 10 to 12 pages long and follow a standard template.

37. The investor can then engage a funds manager to invest their funds in accordance with the portfolio mix in the SIPO for a fee that is usually a percentage of the funds under management. The fee varies according to both the mix of assets and the extent to which the fund manager is required to actively select investments, as opposed to investing in the baskets of investment that reflect the general movements in a particular market. Depending on the size of the portfolio and the mix of assets defined in the SIPO the funds manager may either invest in other managed funds or sub-contract to other funds managers.

38. Usually the SIPO and the contract with the funds manager will be designed to deliver an investment portfolio that is efficient for the mix of return and risk chosen by the investor. In other words the portfolio diversifies the holdings of individual assets so that the investor can expect to receive the average return on that group of assets. I would expect that this model of investment management would be appropriate:

38.1 temporarily for the whole settlement in the initial years after the settlement is received (to allow time to develop decision processes and for other investment strategies and opportunities to be considered); and

38.2 permanently for that part of the settlement required to support any long term regular distribution to the claimants.

39. Therefore the comparison of the economic consequences of the two settlement options would depend on any difference in the management fees charged for one versus five funds and any barriers to entry for the smaller sized funds to diversification opportunities.

40. The results of my literature search are not conclusive on this point, though many of the articles indicate economies of scale for funds where the funds were larger than $100 million. Therefore it is unclear from this source how applicable these economies are to funds of below that size in New Zealand at present.

41. Discussions with local fund managers indicate:

41.1 a negligible difference in funds management fees between one large fund and five smaller funds on the scale contemplated;

41.2 low likelihood of barriers to entry to the type of funds that would contemplated under the SIPO i.e. cash, fixed interest, NZ equities and overseas equities (from the main markets).

Other effect – timing

42. I see a further economic effect relating to differences in process that are likely to be favoured by a single large settlement compared with the five smaller ones.

43. Time taken to negotiate the settlement. Any further delay in the negotiation of the settlement also delays the date from which Ngapuhi can earn a return on the settlement. For example assuming Ngapuhi could achieve a return on their funds of 5 percent year, a two year delay would mean their forecast funds would always be 10.3 percent lower than if settled without the delay. The longer the delay the greater the compound effect of the foregone return.

Options

44. If Ngapuhi enter negotiations now with the Crown as one group they still have a range of options to create separate governance arrangements for parts of the settlement. In my view it is likely to be easier for Ngapuhi to determine how to separate the management of the assets of single pool of cash than it would be to agree on how to merge some or all of the individual $20 million settlements back into a larger group.

Conclusion

45. I have been asked to consider whether there are economic advantages to Ngapuhi in entering settlement negotiations leading towards a single Ngapuhi settlement as opposed to groups within Ngapuhi entering five separate Treaty settlement negotiations leading towards five separate Treaty settlements.

46. My advice is that there are likely to be the following economic advantages to Ngapuhi of entering into a single settlement with the Crown rather than five separate settlements. A single large fund:

46.1 is likely to be able to attract higher quality governance and management than five separate funds;

46.2 preserves the option to for Ngapuhi to operate as an active investor, while being able to have a range of investments. This significant difference in investment approach seems to have delivered higher returns for the iwi in the limited sample I have reviewed;

46.3 will create modest economies of scale in the costs of administering and reporting on the fund; and

46.4 avoids the cost to Ngapuhi of foregone returns from further delays in the settlement process.

Signed:

Dr John Yeabsley

Date: 19 November 2014

APPENDIX A TREATY SETTLEMENTS

TABLE 1 COMPLETED OTS NEGOTIATIONS

Redress value is recorded in $million and the year refers to the year of the deed of settlement

Settlements above the median			Settlements below the median		
Claimant	**Redress**	**Year**	**Claimant**	**Redress**	**Year**
Ngāi Tahu	170.0	1997	Ngāti Manawa	12.2	2009
Waikato-Tainui raupatu	170.0	1995	Ngāti Tama ki Te Tau Ihu	12.0	2013
Commercial Fisheries	170.0	1992	Ngai Tāmanuhiri	11.1	2011
Ngāi Tuhoe	169.0	2012	Ngāti Rārua	11.0	2013
Central North Island Forests Iwi Collective	161.0	2008	Ngāti Kōata	11.0	2012
Ngāti Porou	90.0	2010	Te Ātiawa a Māui	11.0	2012
Ngāti Toa Rangitira	70.0	2012	Te Arawa (Lakes)	10.0	2004
Raukawa	50.0	2014	Tuwharetoa (Bay of Plenty)	10.0	2003
Ngāti Awa	42.0	2003	Ngāti Makino	9.6	2011
Ngāti Ruanui	41.0	2001	Ngāti Whare	9.6	2009
Affiliate Te Arawa Iwi and Hapu	38.0	2006,	Te Roroa	9.5	2005
Ngaa Rauru Kiitahi	31.0	2003	Ngāti Manuhiri	9.0	2011
Ngāti Apa ki te Rā Tō	28.0	2010	Waitaha	7.0	2011
Rangitāne o Wairau	25.0	2010	Ngāti Rangiwewehi	6.0	2012
Taranaki Whanui ki Te Upoko o Te Ika	25.0	2008	Tapuika	6.0	2012
Ngāti Kuia	24.0	2010	Ngati Whakaue	5.2	1994
Maungaharuru Tangitu Hapū	23.0	2013	Ngāti Turangitukua	5.0	1998
Rongawhakaata	22.2	2011	Pouakani	2.7	1999
Ngāti Whātua o Kaipara	22.1	2011	Maraeroa A and B Blocks	1.8	2011
Ngāti Pahauwera	20.0	2010	Ngati Rangiteaorere	0.8	1993
Ngāti Whātua Ōrakei	18.0	2011	Ngāti Rangiteaorere	0.8	2013
Ngāti Apa (North Island)	16.0	2008	Hauai	0.7	1993
Te Uri o Hau	15.6	2000	Waimakuku	0.4	1995
Ngāti Mutunga	14.0	2005	Te Maunga	0.1	1996
Ngāti Tama	14.0	2001	Rotoma	0.0	1996

Source: NZIER

1. The preceding table lists the value and date of the settlement deed for settlements listed as completed by the Office of Treaty Settlements.

2. In addition to the settlements in the table OTS has also reached the following settlements where the value of redress is not stated:

   - Waikato River (including the river interests of Waikato-Tainui 2009; Te Arawa 2010; Ngati Raukawa 2010; Ngāti Tuwharetoa 2010; and Maniapoto 2010)
   - Tāmaki Makaurau Collective Settlement 2012
   - Ngā Wai o Maniapoto 2010
   - Waitomo 1990 which included a loan of $1 million.