

# Derivatives Policy

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## Contents

1. Background .....	3
2. Objective .....	3
3. Definitions.....	3
4. Scope .....	3
5. Delegations and Authorities .....	5
6. Use of derivatives.....	5
7. Standards for use of derivatives .....	6
8. Reporting .....	6
9. Legislative Compliance.....	7
10. Control Section.....	7
11. Schedule 1: Responsibilities .....	8
12. Schedule 2: Ministerial Consents & Expectations .....	9
13. Schedule 3: Reporting Framework.....	10
14. Schedule 4: Standards & framework for managing derivative Investment and Non-Investment Risk.....	11
15. Schedule 5: Legal Compliance .....	23

## 1. Background

- 1.1 Derivatives are financial instruments whose value and characteristics are derived from, or linked to, underlying assets, indexes, or reference rates (such as exchange rates or interest rates).
- 1.2 In accordance with Section 50<sup>1</sup> of the New Zealand Superannuation and Retirement Income Act 2001 (Act), we have sought and received the Minister of Finance's approval to use derivatives and other specific instruments such as repos which are subject to certain conditions.
- 1.3 The Minister of Finance expectation is that we must use derivatives judiciously, and that where relevant, there is a strong case for their use relative to equivalent physical exposures (i.e. the use is efficient).

## 2. Objective

- 2.1 To implement effective controls and frameworks to ensure that all aspects of derivative use (both internal and externally managed) are effectively managed and in compliance with our investment, governance and legislative requirements.

## 3. Definitions

- 3.1 To aid with interpretation of this policy we have a Glossary of Investment Terms, which defines all investment and technical terms used in our policy documents. References to other documents are italicised.

## 4. Scope

- 4.1 This Policy applies to all exchange-traded and over the counter ("OTC") derivatives.
- 4.2 This policy covers using derivatives for the following activities:
  - Implementing and maintaining Strategic Tilting;
  - Managing the Fund foreign currency exposure;
  - Managing Internal Investment Mandates;
  - Managing the funding, rebalancing and liquidity management process;
  - External managers who are appointed via the Externally Managed Investments Policy;
  - Investing into a pooled external fund; and
  - Managers operating under a Transition Management Agreement.

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<sup>1</sup> Section 50 Borrowing

(1) The Guardians may not, except with the approval of the Minister of Finance, —

(a) borrow money (in respect of the Fund); nor

(b) mortgage or charge any of the real or personal property of the Fund, whether present or future, as security; nor

(c) hold any financial instrument that places or may place a liability or a contingent liability on the Fund, or the Crown.

(2) The Minister's approval may be given for any class of transactions in subsection (1)(a) to (c).

#### 4.3 Risks inherent in derivative use are summarised below together with the policy framework for managing those risks:

<b>Risk</b>	<b>Definition</b>	<b>Where is this risk addressed?</b>	<b>Policy reference if out of scope</b>
Legal & regulatory (1)	Risk of inadequate or deficient consents to undertake an activity and regulatory changes impacting our use of derivatives.	Derivatives Policy <ul style="list-style-type: none"> <li>Section 6 (Use of derivatives), Schedule 2 (Ministerial Consents &amp; Expectations)</li> </ul>	
Legal & regulatory (2)	Inadequate legal documentation which could result in exposure be different from that expected or returns different to those expected	<ul style="list-style-type: none"> <li>Portfolio Completion and Internally Managed Securities Policy (PCIMS)</li> <li>Externally Managed Investments Policy (EMI)</li> </ul>	<ul style="list-style-type: none"> <li>Counterparties (Section 9), Schedules 6, 6A, 6B;</li> <li>Internal Investment Mandates (Section 7, 9, Schedule 4);</li> <li>Product Approval (Section 8, Schedule 5, 5A);</li> <li>New investment implementation (Section 9, Schedule 5),</li> <li>Active Investment Decision Framework (Schedule 3)</li> </ul>
Counterparty	Risk that a counterparty with whom a derivative contract is contracted fails to perform contractual obligations and / or defaults.	<ul style="list-style-type: none"> <li>PCIMS</li> <li>EMI</li> </ul>	<ul style="list-style-type: none"> <li>Counterparties (Section 9), Schedules 6, 6A, 6B</li> <li>Investment Manager Search &amp; Selection (section 7), New investment implementation (Section 9, Schedule 5), Monitoring and Conviction (Section 10, Schedule 3)</li> </ul>
Market	Risk that may result when market conditions develop differently than expected or when there are mismatches between actual market exposure and the market exposure from the derivative.	<ul style="list-style-type: none"> <li>PCIMS</li> <li>EMI</li> <li>Investment Risk Allocation Policy</li> </ul>	<ul style="list-style-type: none"> <li>Internal Investment Mandates (Section 7, Schedule 4)</li> <li>Monitoring and Conviction (Section 11, Schedule 3)</li> <li>Investment Constraints (Section 10, Schedule 7)</li> </ul>
Complexity	A derivative may behave differently than expected because of the failure to identify and assess the risks associated with the usage of derivatives.	<ul style="list-style-type: none"> <li>PCIMS</li> <li>EMI</li> </ul>	<ul style="list-style-type: none"> <li>Product Approval (Section 8, Schedule 5, 5A)</li> <li>New Investment Implementation (Section 9, Schedule 5)</li> </ul>
Liquidity	Risk that a particular position may not be able to be, or cannot be easily, unwound or offset at or near the previous market price because of inadequate market depth or because of disruptions in the market place.	<ul style="list-style-type: none"> <li>PCIMS</li> <li>EMI</li> </ul>	<ul style="list-style-type: none"> <li>New Product Approval (Section 8, Schedule 5, 5A) &amp; Minimum Liquidity Requirement (Schedule 11)</li> <li>New Investment Implementation (Section 9, Schedule 5)</li> <li>Investment Constraints (Section 10, Schedule 7)</li> </ul>
<b>Risk</b>	<b>Definition</b>	<b>Where is this risk addressed?</b>	<b>Policy reference if out of scope</b>

Valuation	Risk that an accurate and timely market value of a derivative cannot be obtained which results in delays or errors in valuations and incorrect or incomplete posting of collateral supporting derivative positions.	<ul style="list-style-type: none"> <li>Investment Valuation Policy</li> <li>PCIMS</li> </ul>	<ul style="list-style-type: none"> <li>Valuation methodology and frequency categories (Section 2, 3, 7)</li> <li>Counterparties (Section 9), Schedules 6, 6A, 6B</li> </ul>
Operational	Risk of loss from inadequate or failed internal processes, people and systems or from external factors.	<ul style="list-style-type: none"> <li>PCIMS</li> <li>Risk Management Policy</li> <li>EMI</li> </ul>	<ul style="list-style-type: none"> <li>Authorised Dealers and Dealing Controls (Section 7, 10,)</li> <li>Proper instruction framework (Schedule 3A, 3B) and Fraud Risk Management Framework (Schedule 7)</li> <li>Monitoring and Conviction (Schedule 3, 11)</li> </ul>

## 5. Delegations and Authorities

- 5.1 The Delegations Policy governs the delegations and authorities that apply in all policy documents. In the event of any discrepancy between this policy and the Delegations Policy the Delegations Policy will prevail. There are no delegations specific to this policy.
- 5.2 The Board has reserved certain matters either to itself, a committee of the Board or the Chief Executive. Those matters are outlined in the Delegations Policy. All other matters are delegated to the Chief Executive who may sub-delegate them to Guardians' staff. All delegates and sub-delegates must exercise their authorities in compliance with the general conditions of delegation and sub-delegation set out in Schedule 2 of the Delegations Policy.
- 5.3 There are certain responsibilities inherent under this policy. Those responsibilities, and the person responsible for them, are outlined in Schedule 1.

## 6. Use of derivatives

- 6.1 We will only use derivatives consistent with our Act, regulations, ministerial consents and directions and the investment objectives of the Fund.
- 6.2 Ministerial consents in respect of derivatives must be maintained in Schedule 2.
- 6.3 Derivative use in respect of the investment objectives of the Fund include implementing investment strategies (internally or external) or transitions in a low cost and efficient manner; hedging and controlling risks; altering the Funds' market (systematic) exposure; constructing portfolios with risk and return characteristics that could not be easily created with cash market securities; and creating or managing liquidity.
- 6.4 We may permit external investment managers to use derivatives where we are satisfied the investment manager has the necessary controls in place to ensure their judicious and efficient use and such use is consistent with the investment guidelines given to the investment manager.
- 6.5 We may permit internal use of derivatives where we are satisfied the activity has the necessary controls in place to ensure their judicious and efficient use and such use is consistent with the investment guidelines in the internal investment mandate.

## 7. Standards for use of derivatives

*We will ensure we maintain appropriate standards to evaluate the competency of internal and external investment managers to use derivatives as part of their investment management.*

7.1 We will maintain and adhere to standards in using derivatives that ensure:

- their use is judicious<sup>2</sup> (i.e. we show good judgment) and that where relevant, there is a strong case for their use relative to physical exposures (i.e. we must demonstrate the economic benefit from derivative use is measurable and transparent) with well managed processes to assess and monitor risk;
- the use of derivatives is usually sub-ordinate to the investment strategy to which they are used (the only exception being some sub-strategies in the Direct Arbitrage Strategy).

7.2 The standards which we apply to derivatives use are maintained in Schedule 4.

7.3 Schedule 4B contains in a summary of how risks inherent in derivative use are managed. This is a summary of the risk management processes described in the Portfolio Completion and Internally Managed Securities Policy, Externally Managed Investments Policy, Risk Management Policy and Investment Risk Allocation Policy (“**Relevant Policies**”). For the purposes of the Derivatives Policy, if there are inconsistencies between Schedule 4B of the Derivatives Policy and the Relevant Policies, then the Relevant Policies will prevail.

## 8. Reporting

8.1 We must report to the Investment Committee, Board, The Treasury and the Minister of Finance on the following matters:

- each quarter we will provide a derivatives activity dashboard that reports on (internal investment mandates only) gross derivative exposure, changes in gross derivatives exposure and drivers of derivatives use, to demonstrate that the use of derivatives is judicious and efficient and
- each quarter we will attest that use of derivatives in the Investment Management Agreement (IMA) and internal investment mandates is consistent with the Act, Ministerial Consents and the Ministers Letter of Expectations.

8.2 An outline of the reporting framework must be maintained in Schedule 3.

8.3 We will report proposed material changes to the following schedules to the Board for their approval:

- Schedule 2: Ministerial Consents and Expectations
- Schedule 3: Reporting Framework

8.4 We must report to the Board, for their information, material changes to the following schedules:

- Schedule 1: Responsibilities
- Schedule 4: Standards & framework for managing derivative Investment and Non-Investment Risk
- Schedule 5: Legal Compliance

<sup>2</sup> The Oxford Dictionary definition of “judicious”: *Having, showing, or done with good judgement*

## 9. Legislative Compliance

*We have a legislative compliance framework to ensure that we comply with our legislative obligations. In each of our policies we list specific legislation that might impact on the activities covered by that policy. The list is not always exhaustive as often the law is specific to a particular aspect of the activity or jurisdiction in which the activity occurs.*

9.1 We will ensure that all our activities under this policy comply with our legislative obligations and give effect to our legislative compliance framework.

9.2 A list of legislation that potentially impacts on the activities under this policy must be maintained in Schedule 5.

## 10. Control Section

Approved this 31<sup>st</sup> day of March 2015

GM Portfolio Completion: \_\_\_\_\_

Chief Executive Officer: \_\_\_\_\_

Board Chairman: \_\_\_\_\_

## 11. Schedule 1: Responsibilities

<b>GM Portfolio Completion</b> will:	<ul style="list-style-type: none"> <li>ensure this policy is kept current and relevant to the activities being undertaken (including schedules 1-4);</li> <li>ensure this policy is reviewed every five years.</li> <li>maintain and adhere to the standards and framework for managing derivative investment and Non-Investment Risk Management</li> <li>attest each quarter to the Investment Committee, Board and Minister of Finance that the use of derivatives within internal investment mandates is consistent with the Act and the Ministerial Consents.</li> </ul>
<b>Chief Investment Officer</b> will:	<ul style="list-style-type: none"> <li>maintain and adhere to the standards and framework for managing derivative investment and Non-Investment Risk Management</li> <li>attest each quarter to the Investment Committee, Board and Minister of Finance that the use of derivatives used in connection with IMA's is consistent with the Act and the Ministerial Consents.</li> </ul>
<b>Head of Portfolio Completion &amp; Head of Portfolio Investments</b> will:	<ul style="list-style-type: none"> <li>maintain and adhere to the standards and framework for managing derivative investment and Non-Investment Risk Management</li> </ul>
<b>Authorised Dealers</b> will:	<ul style="list-style-type: none"> <li>use derivatives consistent with the requirements of the Internal Investment Mandates and Ministerial Consents</li> <li>only deal with Authorised Counterparties and in derivatives on the Approved Products list maintained in the Portfolio Completion and Internally Managed Securities Policy.</li> </ul>
<b>Head of Portfolio Risk and Compliance</b> will:	<ul style="list-style-type: none"> <li>report quarterly on: <ul style="list-style-type: none"> <li>derivatives used within internal investment mandates to the Investment Committee, Board, Treasury and the Minister of Finance.</li> </ul> </li> </ul>
<b>Head of Enterprise Risk</b>	<ul style="list-style-type: none"> <li>ensure Op DD staff complete appropriate due diligence on external manager and funds where derivatives transaction are undertaken or contemplated</li> </ul>
<b>Head of Internal Audit</b> will:	<ul style="list-style-type: none"> <li>report material policy breaches notified through the Learning and Opportunities reporting process immediately to the Risk Committee (RC) and Board</li> <li>report all policy breaches notified through the Learning and Opportunities reporting process to the subsequent Risk Committee, Audit Committee and Board meetings</li> </ul>
<b>General Counsel</b> will:	<ul style="list-style-type: none"> <li>ensure schedule 5 (legal compliance) is kept current</li> <li>report material changes to the schedules of this policy as part of the annual SIPSP review to the Risk Committee and Board meetings as well as under the no surprises protocol.</li> </ul>

Responsibilities approved by Chief Executive on 31 March 2015, and updated 28 November 2017



## 12. Schedule 2: Ministerial Consents & Expectations

The consents in respect of derivatives are noted below:

Approvals	Class of transactions	Relevant part of the SIPSP	Reference
The Guardians may, and may permit its fund managers, transition manager, currency managers and its custodian to enter into foreign exchange and other derivatives in relation to the Fund	Section 50(1)(1c) of the Act	Section 9 Derivatives	27 Aug 2009  Super Docs Ref <a href="#">30146</a>
The Guardians may, and may permit its investment managers, transition managers, currency managers and its custodian to enter into repurchase agreements and derivatives transactions and to enter into the repurchase agreements, securities lending and derivatives transactions, requiring the posting of collateral or margin by that party in relation to the Fund, or the receipt, holding and return of collateral or margin (in whole or in part, and whether or not in cash) by that party in relation to the Fund.	Section 50(1)(a), (b) and (c) of the Act	Section 9 Derivatives  Section 11 Securities Lending	27 Aug 2009  Super Docs Ref <a href="#">30146</a>

In addition to the consents, from time to time the Minister of Finance may write to the Guardians to detail expectations of the Guardians. In 2013, 2014 and 2015, the MOF wrote to the Guardians setting out expectations in relation to derivatives, that they should be used “judiciously and that, where relevant, there is a strong case for their use relative to equivalent physical exposures”.

**Approved by Board on 31 March 2015**

### 13. Schedule 3: Reporting Framework

Report	Frequency required and by whom	Minimum information required
Reporting on derivative use in internal investment mandates	Quarterly to the IC, Board.  By Portfolio Risk and Compliance	<ul style="list-style-type: none"> <li>Gross and net derivative exposures</li> <li>Gross derivative exposures – by type, quarterly change, by Value Add strategy</li> <li>Deviation from Reference Portfolio Exposure</li> <li>Split of how much of the Reference Portfolio exposure is completed using derivatives vs. passive managers</li> </ul>
Attestation that use of derivatives undertaken by the Guardians and under IMA's is consistent with Ministerial Consents and MOF letter of expectations	Quarterly to the IC, Board and Minister of Finance.  By GM Portfolio Completion and Chief Investment Officer	<ul style="list-style-type: none"> <li>Positive confirmation</li> </ul>
Breach of this policy	By GM Portfolio Completion and Chief Investment Officer  If material: immediately to IC, RC and AC Otherwise: to subsequent IC, RC and AC meetings Also to Head of Internal Audit via a Learning and Opportunity Form	<ul style="list-style-type: none"> <li>Relevant details</li> <li>Lessons learned for future conduct</li> <li>Remedial actions taken</li> </ul>
Material changes to Schedules of this policy	By GM Portfolio Completion and Chief Investment Officer  Reported six monthly to subsequent, IC, RC and Board meetings and under no surprises protocol.	<ul style="list-style-type: none"> <li>Details of change and reasons for change.</li> </ul>

Approved by Board on 31 March 2015

## **14. Schedule 4: Standards & framework for managing derivative Investment and Non-Investment Risk**

Given the nature of and the risks associated with derivatives, the risk management activities associated with derivatives are more extensive. The Guardians will undertake an assessment to determine which specific types of derivatives should be allowed and the appropriate limits on their use.

### **Standards**

Prior to, and on an ongoing basis, any use of a strategy in each internally or externally managed mandate that employs derivatives requires:

- Identification and assessment of the derivative specific risks;
- Derivative and counterparty guidelines, controls and monitoring reports or equivalent risk management structure;
- Operational procedures for control and monitoring activity;
- Staffing resources for effective management and oversight; and
- Appropriate documentation and / or written investment guidelines.

The form of the documentation required to achieve this will vary in each circumstance.

Derivative use spans a range of investment access points. We group these into three categories:

1. External investment managers appointed by the Fund under the terms of an Investment Management Agreement (IMA). In these cases the manager is typically managing a segregated portfolio of assets held directly in the Fund's name.
2. Investing in collective investment vehicles of the manager. In these cases the underlying investments are owned by the collective investment vehicle (CIV) and owners hold interests in the CIV.
3. Internal investment management operated under Internal Investment Mandates approved by the Chief Executive on the recommendation of the Investment Committee and operated in accordance with the Policy or Direct Investments approved and operated under the Delegations Policy.

Our standards in relation to managing risk in relation to these three investment access points is detailed in Schedule 4A.

#### 14. Schedule 4A: Standards & framework for managing derivative Investment and Non-Investment Risk

Risk	External IMA	Collective investment vehicle	Internal Investment Mandate
<b>Market risk</b>	<i>Risk that may result when market conditions develop differently than expected or when there are mismatches between actual market exposure and the market exposure from the derivative.</i>		
	<p><b>Monitoring</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 11 Monitoring; Schedule 3: Conviction and Monitoring Framework</p> <p><i>After partnering with an investment manager we monitor and report on them on an on-going basis. There are three different types of monitoring:</i></p> <ol style="list-style-type: none"> <li><i>1. Through investment monitoring we evaluate both investment risk and returns and the manager's investment competency.</i></li> <li><i>2. Through compliance monitoring we ensure that managers are adhering to the investment guidelines for each investment.</i></li> <li><i>3. Through operational monitoring we review a manager's operational competency and effectiveness.</i></li> </ol>	<p><b>Monitoring</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 11 Monitoring; Schedule 3: Conviction and Monitoring Framework,</p> <p><i>After investing into a collective investment vehicle we will, to the extent reasonably practicable monitor and report on them on an on-going basis. There are two different types of monitoring:</i></p> <ol style="list-style-type: none"> <li><i>1. Through investment monitoring we evaluate both investment risk and returns and the manager's investment competency.</i></li> <li><i>2. Through operational monitoring we review a manager's operational competency and effectiveness.</i></li> </ol>	<p><b>Internal Investment Mandates:</b></p> <p>Relevant Policy: PCIMS Section 7 Internal Investment Mandates; PCIMS Schedule 4 Approved Internal Investment Mandates</p> <p><i>Each Internal Investment Mandate (IIM) governs the internal management of assets and requires the effective market exposure of assets (including derivatives) in each IIM to be monitored on a regular basis.</i></p> <p><b>Stress Testing:</b></p> <p>Relevant Policy: PCIMS Section 1 Responsibilities</p> <p><i>The Chair of the Funding and Treasury Group will arrange for periodic stress testing. That testing will include stress testing of option holding investment portfolios</i></p>

	<p><b>Investment Constraints:</b></p> <p>Relevant Policy: Investment Risk Allocation Policy Section 10 Investment Constraints Schedule 4 Constraints</p> <p><i>We will establish capital and risk constraints as appropriate to manage investment risk within the Fund. All capital and risk constraints must be detailed.</i></p> <p><b>Reporting:</b></p> <p><i>We will monitor and manage aggregate market risk through the Fund Rebalancing Tool, Currency Hedging Tool and the Risk Budget dashboard (which details the Active Risk Budget and Fund Volatility).</i></p>	<p><b>Investment Constraints</b></p> <p>Relevant Policy: Investment Risk Allocation Policy Section 10 Investment Constraints Schedule 4 Constraints</p> <p><i>We will establish capital and risk constraints as appropriate to manage investment risk within the Fund. All capital and risk constraints must be detailed.</i></p> <p><b>Reporting:</b></p> <p><i>We will monitor and manage aggregate market risk through the Fund Rebalancing Tool, Currency Hedging Tool and the Risk Budget dashboard (which details the Active Risk Budget and Fund Volatility).</i></p>	<p><b>Investment Constraints:</b></p> <p><i>Relevant Policy: Investment Risk Allocation Policy Section 10 Investment Constraints Schedule 4 Constraints</i></p> <p><i>We will establish capital and risk constraints as appropriate to manage investment risk within the Fund. All capital and risk constraints must be detailed.</i></p> <p><b>Reporting:</b></p> <p><i>We will monitor and manage aggregate market risk through the Fund Rebalancing Tool, Currency Hedging Tool and the Risk Budget dashboard (which details the Active Risk Budget and Fund Volatility).</i></p>
<b>Liquidity risk</b>	<p><i>Liquidity Risk is the risk that a particular position may not be able to be, or cannot be easily, unwound or offset at or near the previous market price because of inadequate market depth or because of disruptions in the market place.</i></p>		
	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 9 New Investment Implementation; Schedule 5 New Investment Implementation Framework</p>	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 9 New Investment Implementation; Schedule 5 New Investment Implementation Framework</p>	<p><b>New Products:</b></p> <p>Relevant Policy: PCIMS Section 8 &amp; Schedule 5 New Product Approval</p>

	<p><i>We will maintain and adhere to a new investment implementation (and termination) process that ensures that legal, operational, responsible investment, reputational, finance, or tax, issues relating to either the manager or the investment have been identified and managed appropriately.</i></p> <p><i>As part of the investment manager selection process, an assessment of liquidity risk in respect of derivative use will be conducted.</i></p>	<p><b>Investment Framework</b></p> <p><i>We will maintain and adhere to a new investment implementation (and termination) process that ensures that legal, operational, responsible investment, reputational, finance, or tax, issues relating to either the manager or the investment have been identified and managed appropriately.</i></p> <p><i>As part of the fund selection process, where possible an assessment of liquidity risk in respect of derivative use will be conducted.</i></p>	<p><i>The new Product Approval process will assess market liquidity of new instrument.</i></p> <p><b>Liquidity:</b></p> <p>Relevant Policy: PCIMS Schedule 2 Liquidity Management Framework</p> <p><i>The Liquidity Management Framework sets Minimum Liquidity Requirement to manage daily collateral calls that will arise from use of derivatives.</i></p> <p><b>Reporting:</b></p> <p><i>We will monitor Fund wide liquidity via the Liquidity Replenishment System and the Minimum Liquidity Requirement.</i></p>
<b>Counterparty risk</b>	<p><i>Risk that a counterparty with whom a derivative contract is contracted fails to perform contractual obligations and / or defaults.</i></p>		
	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 7, 9; Schedule 3: Conviction and Monitoring Framework,</p>	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 9; Schedule 5: New</p>	<p><b>Counterparties:</b></p> <p>Relevant Policy: PCIMS Section 9 Counterparty, Portfolio Completion Agent and non-master Custodian selection and exposure management</p>

	<p>Schedule 5: New Investment Implementation Framework</p> <p><i>We will maintain and adhere to a new investment implementation (and termination) process that ensures that legal, operational, responsible investment, reputational, finance, or tax, issues relating to either the manager or the investment have been identified and managed appropriately.</i></p> <p><b>Monitoring</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 10 Monitoring; Schedule 3: Conviction and Monitoring Framework</p> <p><i>As part of our ongoing operational due diligence, periodic reviews will be designed to ensure the counterparty risks are well managed and are consistent with expectations and the IMA.</i></p>	<p>Investment Implementation Framework</p> <p><i>We will maintain and adhere to a new investment implementation (and termination) process that ensures that legal, operational, responsible investment, reputational, finance, or tax, issues relating to either the manager or the investment have been identified and managed appropriately.</i></p> <p><b>Monitoring</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 10 Monitoring; Schedule 3: Conviction and Monitoring Framework</p> <p><i>We will, to the extent reasonably practicable, conduct periodic reviews to ensure the counterparty risks are well managed and are consistent with expectations and the applicable fund's investment objectives and profile.</i></p>	<p>Internal Investment Mandates; PCIMS Schedule 6, 6A, 6B,</p> <p><i>Counterparties are selected (and retained) after an assessment of their credit quality and their competence with respect to a Product. Counterparties are continuously monitored under the creditworthiness framework: falling below set standards will lead to suspension of trading with that Counterparty.</i></p> <p><i>We will set limits and monitor our Direct Exposure to counterparties</i></p> <p><i>All OTC derivatives must be executed with Approved Counterparties and all cleared derivatives must be executed with approved central clearing counterparty via an approved clearing broker.</i></p> <p><b>Reporting:</b></p> <p><i>We will monitor counterparty via the Counterparty Creditworthiness Monitor and Limits reporting.</i></p>
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<b>Valuation risk</b>	<i>Risk that an accurate and timely market value of a derivative cannot be obtained which results in delays or errors in valuations and incorrect or incomplete posting of collateral supporting derivative positions.</i>		
	<p><b>Investment Valuation:</b></p> <p>Relevant Policy: Investment Valuation Policy; Schedule 2: Valuation methodology categories</p> <p><i>Valuations methodologies and frequencies must be in place for derivative instruments.</i></p>	<p><b>Investment Valuation:</b></p> <p>Relevant Policy: Investment Valuation Policy; Schedule 2: Valuation methodology categories</p> <p><i>Valuations methodologies and frequencies must be in place for derivative instruments.</i></p>	<p><b>Investment Valuation:</b></p> <p>Relevant Policy: Investment Valuation Policy Section 2,3,7; Schedule 2: Valuation methodology categories</p> <p><i>Valuations methodologies and frequencies must be in place for derivative instruments.</i></p> <p><b>Counterparties:</b></p> <p>Relevant Policy: PCIMS Section 9 Counterparty, Portfolio Completion Agent and non-master Custodian selection and exposure management; Internal Investment Mandates; PCIMS Schedule 6.</p> <p><i>Minimum standards are set for reporting exposures to ensure that market to market valuations are agreed and collateral exchanged under the Credit Support Agreements.</i></p>



Operational Risk	Risk of loss from inadequate or failed internal processes, people and systems or from external factors.		
	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 9; Schedule 3: Conviction and Monitoring Framework, Schedule 5: New Investment Implementation Framework</p> <p><i>We will maintain and adhere to an investment manager search and selection framework that focuses on using our own and others' judgement, and systematic and other objective sources and tools, to assess any potential manager in terms of their:</i></p> <p><i>Competence to execute on the specific opportunity we employ them to access, including appropriate use of derivatives where such use is necessary to implement the investment opportunity</i></p>	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 9; Schedule 3: Conviction and Monitoring Framework, Schedule 5: New Investment Implementation Framework</p> <p><i>We will maintain and adhere to an investment manager search and selection framework that focuses on using our own and others' judgement, and systematic and other objective sources and tools, to assess any potential manager in terms of their:</i></p> <p><i>Competence to execute on the specific opportunity we employ them to access, including appropriate use of derivatives where such use is necessary to implement the investment opportunity</i></p>	<p><b>Direction Transaction Management:</b></p> <p>Relevant Policy: PCIMS Section 10 Direct Transaction Management</p> <p>Relevant Policy: PCIMS Section 7: Authorised Dealers &amp; Dealing Controls</p> <p><i>Only Authorised Dealers are permitted to enter into derivative transactions for Internal Investment Mandates. The Guardians must ensure that all staff responsible for reviewing investment managers and managing investment mandates are appropriately qualified and experienced. Staff must be supervised as appropriate to their areas of responsibility.</i></p> <p><b>Trading, controls and settlement:</b></p> <p>Relevant Policy: Risk Management Policy, Appendix 3A, 3B Proper Instructions Framework</p> <p><i>All derivative trades will be recorded in an order management system. Appropriate internal controls must be in place between front, middle and back office. All transactions must be settled by the Custodian.</i></p>

	<p><b>Monitoring</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 11 Monitoring; Schedule 3: Conviction and Monitoring Framework,</p> <p><i>Where a manager's mandate allows the use of derivatives we will (at appointment, prior to, and on an ongoing basis), review to ensure there is effective management and oversight of derivative usage:</i></p> <ul style="list-style-type: none"> <li><i>• Applicable derivative documentation and investment guidelines;</i></li> <li><i>• Operational procedures for control and monitoring derivative activity; and</i></li> <li><i>• Staffing resources and capability.</i></li> </ul>	<p><b>Monitoring</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 11 Monitoring; Schedule 3: Conviction and Monitoring Framework,</p> <p><i>Where a commingled vehicle allows the use of derivatives we will (at appointment, prior to, and on an ongoing basis), to the extent reasonably practicable, review via the manager monitoring and Operational Due Diligence process, to ensure there is effective management and oversight of derivative usage:</i></p> <ul style="list-style-type: none"> <li><i>• Applicable derivative documentation and investment guidelines;</i></li> <li><i>• Operational procedures for control and monitoring derivative activity; and</i></li> <li><i>• Staffing resources and capability.</i></li> </ul>	
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<b>Complexity</b>	A derivative may behave differently than expected because of the failure to identify and assess the risks associated with the usage of derivatives.		
	<p><b>New Investment Implementation</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 9; Schedule 5: New Investment Implementation Framework</p> <p><i>We will maintain and adhere to a new investment implementation (and termination) process that ensures that legal, operational, responsible investment, reputational, finance or, tax, issues relating to either the manager or the investment have been identified and managed appropriately</i></p>	<p><b>New Investment Implementation</b></p> <p>Relevant Policy: Externally Managed Investments Policy Section 9; Schedule 5: New Investment Implementation Framework</p> <p><i>We will maintain and adhere to a new investment implementation (and termination) process that ensures that legal, operational, responsible investment, reputational, finance or, tax, issues relating to either the manager or the investment have been identified and managed appropriately</i></p>	<p><b>Product Approval:</b></p> <p>Relevant Policy: PCIMS Section 8 &amp; Schedule 5, 5A New Product Approval</p> <p><i>Complexity risk is mitigated through the identification and assessment of risks associated with the usage of derivatives as part of the New Product Approval process and the Operational Risk Assessment (ORA) process. We only use a new product once we have identified and assessed the risks of implementation and appropriate methods of valuation, and put in place processes to ensure effective management. If the new product is a derivative it must also comply with section 8 (Derivatives) of our Statement of Investment Policies, Standards and Procedures.</i></p> <p><i>Our product approval process includes approval of purposes for the Product and any conditions of approval, as well as the establishment of any applicable Potential Future Exposure (PFE) factor used to measure Counterparty exposure that results from the use of the Product.</i></p> <p><i>The new Product Approval framework is designed to ensure risks of using a new Product have been fully considered before that Product is used for the first time.</i></p>

			<p><b>Approved Products:</b></p> <p>Relevant Policy: PCIMS Schedule 5A Approved Products</p> <p><i>We will maintain a list of Approved Products together with any applicable Potential Future Exposure factors,</i></p>
<b>Legal &amp; Regulatory</b>	<p><i>Legal risk is the risk of inadequate or deficient consents to undertake an activity and regulatory changes impacting our use of derivatives. Or inadequate legal documentation which could result in exposure be different from that expected or returns different to those expected</i></p>		
	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policies:</p> <p>Externally Managed Investments Policy Section 9; Schedule 3: Conviction and Monitoring Framework, Schedule 5: New Investment Implementation Framework</p> <p><b>Investment management agreement (IMA)</b></p> <p>Relevant Policy: Externally Managed Investments Policy Schedule 3: Active Investment Decision Framework.</p>	<p><b>Investment Manager Search and Selection</b></p> <p>Relevant Policies:</p> <p>Externally Managed Investments Policy Section 9; Schedule 3: Conviction and Monitoring Framework, Schedule 5: New Investment Implementation Framework</p> <p><b>Collective Investment Vehicle Investments (CIV)</b></p> <p>Relevant Policy: Externally Managed Investments Policy</p>	<p><b>Internal Investment Mandates:</b></p> <p>Relevant Policies: PCIMS Section 7 Internal Investment Mandates; PCIMS Schedule 4.</p> <p><i>Minimum standards are set for the objectives, documentation, design and operation of each Internal Investment Mandate.</i></p> <p><b>Counterparties:</b></p> <p>Relevant Policy: PCIMS Section 9 Counterparty, Portfolio Completion Agent and non-master Custodian selection and exposure management; Internal Investment Mandates; PCIMS Schedule 6, 6A, 6B.</p>

	<p><i>As part of the investment manager selection the IMA will include provisions relating to the prudential limits, investment objectives, assets (including derivatives) which can be held; and in the case of derivatives, the purposes for which derivatives may be used, the types of derivatives which may be used, the limits of derivative use and reporting requirements.</i></p> <p><b>Legal Compliance:</b></p>	<p>Schedule 3: Active Investment Decision Framework.</p> <p><i>For investments into external funds, which are not governed by an investment management agreement (e.g. a fund vehicle), the fund documentation include provisions relating to the prudential limits, investment objectives, assets (including derivatives) which can be held.</i></p> <p><b>Legal Compliance:</b></p>	<p><i>Minimum standards are set for counterparty selection, monitoring and reporting exposure management.</i></p> <p><b>Product Approval:</b></p> <p>Relevant Policy: PCIMS Section 8 &amp; Schedule 5, 5A New Product Approval</p> <p><i>We only use a new product once we have identified and assessed the risks of implementation and appropriate methods of valuation, and put in place processes to ensure effective management. If the new product is a derivative it must also comply with section 8 (Derivatives) of our Statement of Investment Policies, Standards and Procedures.</i></p> <p><i>Our product approval process includes approval of purposes for the Product and any conditions of approval, as well as the establishment of any applicable Potential Future Exposure (PFE) factor used to measure Counterparty exposure that results from the use of the Product.</i></p> <p><i>The new Product Approval framework is designed to ensure risks of using a new Product have been fully considered before that Product is used for the first time.</i></p> <p><b>Legal Compliance:</b></p>
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	<p>Derivatives Policy Section 6 Use of derivatives; Schedule 2: Ministerial Consents and Expectations</p> <p><i>When undertaking any activity under this policy, legislative considerations must be taken into account and complied with.</i></p>	<p>Derivatives Policy Section 6 Use of derivatives; Schedule 2: Ministerial Consents and Expectations</p> <p><i>When undertaking any activity under this policy, legislative considerations must be taken into account and complied with.</i></p>	<p>Derivatives Policy Section 6 Use of derivatives; Schedule 2: Ministerial Consents and Expectations</p> <p><i>When undertaking any activity under this policy, legislative considerations must be taken into account and complied with.</i></p>
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Approved by Chief Executive on 31 March 2015

## 15. Schedule 5: Legal Compliance

The summary of New Zealand legislation set out below does not purport to be comprehensive or to provide legal advice. If you require any advice on these matters please contact the legal team.

When undertaking any activity under this policy, legislative considerations must be taken into account and complied with. The following legislation is not an exhaustive list as every activity will have legislation governing the activity and this may be different depending on the particular jurisdiction relevant to the activity.

Each financial market has its own specific regulatory regime governing trading. These can change over time or depend on specific thresholds that we may meet as the Fund grows in size.

We need to consider the legislation below carefully as some compliance requirements are triggered right at the start of a transaction even before we engage in negotiations with other parties.

When entering into any form of written documentation including informal “non-binding” heads of agreement it is essential that a legal review of the documentation is carried out to ensure that documents do not contravene or have correctly contemplated the Acts referred to below. The following is a list of New Zealand legislation that may apply to New Zealand governed Internally Managed Mandates. Overseas jurisdictions will often have equivalent legislation.

### Our governing legislation

- Crown Entities Act 2004
- New Zealand Superannuation and Retirement Income Act 2001

### Legislation specific to transactions

- Anti-Money Laundering and Countering Financing of Terrorism Act 2009
- Companies Act 1993
- Contracts (Privity) Act 1982
- Contractual Remedies Act 1979
- Fair Trading Act 1986
- Financial Markets Conduct Act 2013
- Frustrated Contracts Act 1944
- Illegal Contracts Act 1970
- Overseas Investment Act 2005 and Foreign Investment Review Board (Australia)
- Property Law Act 2007
- Takeovers Act 1993 and Takeovers Code, NZX listing rules

### Tax and Accounting legislation

- Financial Reporting Act 2013
- Goods & Services Tax Act 1985
- Income Tax Act 2007
- Tax Administration Act 1994

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## **Other**

- Official Information Act 1982. Our obligations in respect of this Act are covered in the Communications Policy.
- Public Records Act 2005. Our obligations in respect of this Act are covered in the Communications Policy.

## **Overseas legislation and regulation**

- The Dodd–Frank Wall Street Reform and Consumer Protection Act (USA)
- European Market Infrastructure Regulation (EU)
- Foreign Account Tax Compliance Act (USA)

**Approved by Chief Executive on 31 March 2015 and 8 December 2016**