



**NATIONAL SUPERANNUATION FUND LTD**

**THE USE OF DERIVATIVES POLICY**

## THE USE OF DERIVATIVES POLICY

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## THE USE OF DERIVATIVES POLICY

### 1. PURPOSE

- 1.1 The purpose of this policy is to provide the guiding principles for the use and oversight of derivatives in management of the Fund's investment assets.
- 1.2 The objective of this policy is to provide a framework for use and control of derivatives and to ensure the Fund has effective operational, risk management and compliance controls when using derivatives.

### 2. LEGISLATIVE REQUIREMENTS

- 2.1 The primary legislative document governing the superannuation industry is the Superannuation (*General Provisions*) Act 2000 (as amended).
- 2.2 The Trustee Board is also required to adhere to various Prudential Standards and in relation to the use of derivatives. The *Superannuation Prudential Standard 1/2014* Authorised Superannuation Fund Investments (PS 1/2014). Paragraph 34 (a – h) refers in detail.
- 2.3 Prudential Standard 1 / 2014, Paragraph 34 (e) states that "Trustee Board must develop, document, and maintain a Policy on the use of Derivatives, in consultation with the Licensed Investment Manager, and include the policy as part of the Investment Framework".
- 2.4 Prudential Standard 1 / 2014, Paragraph 34 (f) states that "Trustee Board in consultation with the Licensed Investment Manager, must develop, document, and maintain an appropriate risk management framework to capture, measure, monitor and manage the potential risks of any derivatives positions taken directly or indirectly. The risk management system must be sophisticated enough to measure risks on an aggregate basis".
- 2.5 Prudential Standard 1 / 2014, Paragraph 34 (h) states that "The Policy on the Use of Derivatives must be published in the Annual Report to members and be published in the public section of each ASF's web site".

### 3. RESPONSIBILITIES AND ACCOUNTABILITIES

- 3.1 The ultimate responsibility for the sound and prudent investment of members' funds rests with the trustee Board.
- 3.2 The Licensed Trustee has a written Investment Framework governing the selection, management and monitoring of investments risks and ensures the Trustee Board, and all those (internal and external) responsible for implementation of the Framework and the Investment Strategy act with a high degree of integrity and for the benefit of members.

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- 3.3 This Policy on the Use of Derivatives forms part of the totality of systems, structures, policies, processes, and people to address the Trustee Board's responsibilities with regard to investments of the Fund.
- 3.4 This Policy should be read in conjunction with the Investment Framework, and the Risk Management Framework.
- 3.5 The Trustee Board in consultation with the Licensed Investment Manager, has developed a risk management framework to capture, measure, monitor and manage the potential risks of any derivatives positions taken directly or indirectly.
- 3.6 The Investment Division and the Licensed Investment Manager are tasked with the ongoing monitoring of the investment portfolio, including derivatives, if any. The Investment Committee is tasked with regular review of the investment portfolio, including derivatives, if any, and the IC reports to the Trustee Board as part of that regular review.

## 4. DEFINITIONS

- 4.1 A derivative is a financial instrument whose value depends on, or is derived from, the value of some other underlying asset, including but not limited to interest rate, currency rate or a variety of indices.
- 4.2 Generally, there are five main categories of derivatives identified by the assets from which they are derived:
- 4.2.1 Equity derivatives.
  - 4.2.2 Currency derivatives.
  - 4.2.3 Interest rate derivatives.
  - 4.2.4 Credit derivatives; and
  - 4.2.5 Commodity derivatives.
- 4.3 Common types of derivatives include futures contracts, forward contracts, options, and swaps, each with its own regulatory, risk and documentation requirements.
- 4.4 Derivatives can be traded through exchanges or privately 'over the counter' (OTC).

## 5. AUTHORISED USE OF DERIVATIVES

- 5.1 Paragraph 34 (b) of PS 1 / 2014 establishes responsibilities on members of the Trustee Board (see below 6.3.2). Accordingly, The Trustee Board will set a very high requirement for disclosure and understanding before approving the use of any derivatives.
- 5.2 The Fund's Trust Deed permits the use of derivatives. Section 9.2 (g) of the Trust Deed refers.
- 5.3 That said, the Trustee Board will only permit the use of derivatives subject to certain guiding principles. These are as follows:

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- 5.4 The Licensed Trustee and the Licensed Investment Manager will ensure that the assets and liabilities of the Fund will not include a derivative, except were allowed under Paragraph 34 (b) to (e) of Prudential Standard 1 / 2014. See PS 1 / 2014 paragraph 34 (a).
- 5.5 The Trustee Board will ensure that at any time the assets and liabilities of the Fund will not include a derivative unless each Director of the Trustee Board fully understands and is able to explain the potential risks of any derivatives positions taken directly or indirectly. See PS 1 / 2014 paragraph 34 (b).
- 5.6 Derivatives will only be used to reduce the risk of existing investments or currency positions. See PS 1 / 2014 paragraph 34 (c).
- 5.7 Derivatives may only be used when the exposure is fully covered by the assets of the Fund. PS 1 / 2014 paragraph 34 (d).
- 5.8 Derivatives will not be used to obtain exposure that is substantially different from that which could be obtained through physical securities.
- 5.9 The use of any derivatives would specifically consider liquidity management as part of the consideration in using any derivative.
- 5.10 It is possible that some collective investment vehicles, such as mutual funds, in which the Fund invests may themselves allow derivatives, for other than purely hedging purposes. The Investment Division and the Licensed Investment Manager are required to address the issue of 'embedded derivatives' in such investment vehicles as part of the consideration of any new investment. If such investments are deemed to breach the guiding principles on the use of derivatives, in literal interpretation or in the spirit of these principles, then the Fund will not invest in such an investment.

## 6. REVIEW OF THIS POLICY

- 6.1 This *Policy on the Use of Derivatives* will be reviewed regularly by the Licensed Investment Manager and the Trustee Board, and such a review will be done at least annually.