STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES

Board of Trustees of the National Provident Fund

May 2019

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1 PURPOSE

The National Provident Fund (**NPF**) was established in 1910 to provide state-subsidised pensions to low income earners. Later, it became the statutory provider of superannuation schemes to local government. The NPF Schemes (**Schemes**, or **Scheme**) were closed to new members in 1991.

This Statement of Investment Policies, Standards and Procedures (**SIPSP**) records the governance and management structure for the investment assets of the Schemes, and the policies, parameters and objectives relating to the investment of those assets.

The Board of Trustees of the National Provident Fund (**Board**) and the Government Superannuation Fund Authority have formed a joint venture company, Annuitas Management Limited (**Annuitas**) to engage staff (**Management**) to provide management services to each organisation. The Board has delegated certain operational and advisory functions to Management as set out in the Management Services Agreement between the Board and Annuitas.

The major sections of the SIPSP are:

- Overview
- Governance
- Portfolio Management (including investment principles and the Schemes' objectives)
- Performance Measurement
- Valuation and Reporting
- Risk Management
- Voting

The SIPSP is reviewed and approved periodically by the Board and, in any event, at no less than 12 monthly intervals. Only the Board can approve material changes to this Statement. Amendments are recorded in a version control document.

Further information on NPF is available via website **www.npf.co.nz**.

2 OVERVIEW

2.1 Legislative Framework

The governing legislation for NPF is the National Provident Fund Restructuring Act 1990 (the **NPF Act**). The Board is also bound by some parts of the Financial Markets Conduct Act 2013 and by the KiwiSaver Act 2006, Public Finance Act, Income Tax Act, the Trustee Act 1956 (except that the provisions relating to investment of trust funds shall not apply in respect of the trust deed of an existing Scheme or its property[1]), and various other legislation and regulations.

The Minister of Finance (the **Minister**) appoints the members of the Board and has the power to direct the Board on matters which affect the Crown's risk as guarantor of the benefits payable by the Schemes.

Under the NPF Act, the Board is trustee of the now nine Schemes and of the Global Asset Trust (the **GAT**). The GAT holds the investment assets on behalf of the Schemes. Section 53 of the NPF Act provides the Schemes may invest only in the GAT and bank accounts.

Section 19 of the NPF Act and clause 4.2 of GAT trust deed set out the Board's power to invest the assets held on behalf of the Schemes.

2.2 Crown Guarantee

Under Section 60 of the NPF Act, the Crown guarantees the benefits payable to members of all Schemes. In terms of that guarantee, the Crown is liable for any remaining deficiencies (in the assets) required to meet the liabilities of each Scheme except where a Scheme is wound up.

The trust deeds for NPF's defined contribution and cash accumulation Schemes provide for a minimum earnings rate of 4% (net of tax and expenses) per annum (**minimum earnings rate**). Under section 72 of the NPF Act, in any financial year, where a deficiency (or increase in deficiency) arises as a consequence of the application of the minimum earnings rate to the employer sponsored defined contribution Schemes, the Crown will pay to the Board (by way of subsidy out of public money) such amount as may be required to meet the deficiency.

2.3 Nature of the Schemes

Each Scheme has its own trust deed. There are currently nine Schemes plus the GAT which (in terms of the NPF Act) is also a superannuation scheme. The Schemes are listed below.

Defined Contribution Schemes
• Pension National Scheme
• Lump Sum National Scheme
• Meat Industry Scheme
Defined Benefit Schemes
• DBP Contributors Scheme
• DBP Annuitants Scheme
• Aircrew Superannuation Scheme
Cash Accumulation Schemes
• Pension Cash Accumulation Scheme
• Lump Sum Cash Accumulation Scheme
Pension Scheme
• National Provident Pension Scheme

[1] Refer section 53 of the National Provident Fund Restructuring Act 1990

2.4 Funding of the Defined Benefit Schemes

DBP Contributors Scheme and Aircrew Superannuation Scheme
Actuarial valuations for the Schemes are required, under section 68 of the NPF Act, to be completed at minimum every three years.

In addition, current Board policy is to complete annual actuarial reviews for the DBP Contributors Scheme and the Aircrew Scheme. The actuarial valuations for these two Schemes are used to determine the employer contribution rate required to fund the benefits payable.

Employers are obliged to contribute to these two Schemes as long as the members continue to contribute.

The Minister sets the employer contribution rate for the two Schemes after receiving recommendations from the Board and advice from government officials.

2.5 Crediting and Reserving Policy, and Member Benefits

To support its minimum earnings rate obligation, the Board has adopted and implemented a crediting and reserving policy (the **Policy**) for the defined contribution and cash accumulation Schemes (the **DC Schemes**).

Under the Policy some of the investment earnings above 4% in good investment years are held in reserve by the DC Schemes to support both the minimum earnings rate and reduce the risk to the Crown in respect of the payment of benefits in the future.

The Board sets minimum target reserve levels for each DC Scheme. The current target reserve level is 10% of the contributors' total credits (account balances).

Under the Policy, a DC Scheme's earnings rate is determined by the following formula:

- when the Scheme reserves are greater than or equal to the target reserve level, the earnings rate is equal to the actual investment return, subject to a minimum of 4% net per annum;
- when the Scheme reserves fall short of the target reserve level, the earnings rate is 4% + Scheme reserve level/target reserve level x (actual investment return – 4%), subject to a minimum of 4% net per annum.

2.6 Pension Increases

Pension increases for members of the National Provident Pension Scheme are at the discretion of the Board. In exercising its discretion the Board seeks advice from the Actuary. A key factor taken into account by the Board, in considering whether to approve an increase in pensions, is the solvency position of the Scheme.

Pension increases for members of the DBP Annuitants Scheme are based on the annual increase of the Consumer Price Index as provided for in the trust deed.

3 GOVERNANCE

3.1 Responsibilities of the Board

The Board is responsible for making all decisions relating to the business of NPF and has all the powers necessary for managing, and directing or supervising the business of NPF.

With respect to investment of the assets held on behalf of the Schemes, the Board is responsible for:

- determining investment policies, parameters and objectives for the Schemes;
- determining and implementing asset allocation strategies for the Schemes;
- establishing risk management policies for foreign exchange, interest rate and credit; and
- the appointment, termination and replacement of investment managers, the custodian and the investment adviser.

In setting the investment policies, the Board acts in the best financial interests of the members of the Schemes, while taking into account the interests of the Crown as guarantor of the benefits payable by the Schemes.

Within six months after the end of each financial year, the Board sends to the Minister:

- the annual reports for each of the Schemes, the GAT and the Board;
- the actuarial valuations completed with respect to the Schemes; and
- the report required by Section 67 1(A) of the NPF Act covering:
  - Scheme asset allocations and investment performance;
  - the investment performance of the separate classes of assets;
  - the allocation of costs to Schemes;
  - any changes in the actuarial basis for valuing Scheme liabilities; and
  - solvency positions of the Schemes that provide for discretionary pension increases.

These reports are tabled by the Minister in the House of Representatives.

3.2 Board Objectives

The Board acts in the best financial interest of members, while taking into account the interests of the Crown as guarantor, by setting the following objectives:

Scheme Returns
Optimising investment returns (within risk parameters approved by the Board) and managing costs, while maintaining an appropriate level of resources.

Quality
Continuing to improve quality and efficiency.

Service
Delivering a level of service that addresses members' needs and represents good value.

Compliance
Ensuring compliance with Scheme trust deeds, legislation, regulations and Board policies.

Risk
Ensuring significant risks are identified and managed.

3.3 Delegations and Decision-Making Framework

The Board's governance arrangements are designed to establish good decision-making processes, clearly define fiduciary roles and responsibilities, and to provide effective policies and procedures for management of the Schemes and the assets held on behalf of those Schemes.

The Board's decision-making structure is illustrated in the following diagram:

Decision-Making Framework

Fiduciary Level	Plan		Implement and Review			
	Policy	Strategy	Management		Execution	Control
	Schemes' Policies, Risk Parameters, Objectives and Strategic Asset Allocation	*Active/Passive, Asset Class Strategy and Structure*	*Manager Selection*	*Implementation*	*Security Selection*	*Review for Compliance v. Objectives*
Minister of Finance	May direct on Crown risk					
NPF Board	Decides	Decides	Decides; Oversight role in manager evaluation and monitoring process	Oversees		The Board agrees annual objectives for Management, reviews performance and ensures adequate resources. Reviews investment performance at least quarterly
Management	Recommends	Recommends	Recommends	Decides		Managing and monitoring the investment of the Schemes' assets. Reviews performance of Investment Managers, Custodian, Schemes Administrator
Investment Adviser (s)	Regular comments on Management's reviews		Recommendations sought as required			Reviews compliance with SIPSP.
Custodian					Settles transactions	Independent calculation of investment managers returns
Investment Managers					Decides	Investment mandates and guidelines/ monthly certification

3.4 Investment Committee

Under the NPF Act, the Board may establish committees and delegate to any such committee all or any of its powers. The Chairman of the Board is an ex officio member of each committee. The Board has established an Investment Committee with terms of reference approved by the Board that are reviewed regularly.

3.5 Responsibilities of Management

The Board and the Government Superannuation Fund Authority have formed a joint venture company, Annuitas. The legal relationship between the two organisations is set out in a joint venture document.

The relationship between the Board and Annuitas and the functions Annuitas performs on behalf of the Board are described in a Management Services Agreement. The main function of Annuitas is to provide staff (**Management**) who act in managerial, research and secretarial roles on behalf of the Board.

Management operates under delegated authorities from the Board, as set out in the Management Services Agreement. The Board reviews the delegations on a regular basis. All delegations exercised on behalf of the Board are reported to the Board in arrears.

Delegations continue until they are revoked. Delegations do not prevent the exercise of any power by the Board.

Regarding investment of the Schemes' assets, Management is responsible for:

- implementing the Board's decisions;
- monitoring and reviewing ongoing performance;
- monitoring compliance;
- making recommendations to the Board with respect to changes in policy, strategy and strategic asset allocations;
- dynamic asset allocation (**DAA**) according to prescribed criteria and within prescribed limits;
- evaluating new and monitoring existing investment managers to ensure conviction in their investing abilities; and
- making recommendations to the Board for the appointment, retention or termination of investment managers.

4 PORTFOLIO MANAGEMENT

The Board seeks to maximise investment returns net of costs within risk parameters approved by the Board.

4.1 Investment Principles

To provide a robust, clear foundation for its investment strategy and programme, the Board has agreed a set of Investment Principles, set out below:

INVESTMENT FACTS	INVESTMENT BELIEFS	INVESTMENT STRATEGY
Governance and Investment Objectives		
Each Scheme's members and stakeholders have investment objectives.	Clear objectives improve decision-making and accountability for outcomes.	The Board approves investment objectives for each Scheme including expected return, various measures of risk and a time horizon for measuring performance.
The Board is responsible for achieving the investment objectives of the Schemes and delegates decision-making to managers.	Clear assignment of responsibilities for governance and investment decision-making promote decisiveness, efficiency and accountability.	The Board delegates operational investment functions contractually to Management. It approves the appointment of external investment managers, the independent custodian, the independent Investment Adviser and their respective mandates.

INVESTMENT FACTS	INVESTMENT BELIEFS	INVESTMENT STRATEGY
Asset Allocation		
The lowest expected returns are derived from short term government securities and cash. Higher expected returns are derived primarily from accepting increased risks of capital loss. Diversification across multiple independent sources of return improves a portfolio's ratio of return to risk. Return fluctuation from foreign currency exposures of international assets can be managed separately using forward exchange rate contracts. Risk of capital loss generally increases with the time to potential realisation. Short-term returns from risky assets are very difficult to predict. Market prices are prone to extremes from time to time.	Asset allocation is the largest determinant of a portfolio's risk and return. Equity risk is the most pervasive and reliable source of additional return. Significant exposure to international assets is worthwhile for NZ investors. A degree of foreign currency exposure also lowers overall return volatility and risk of loss from domestic sources but incurs a return penalty. There are other investment risks that provide systematic returns independent of equity risk, including compensation for risk of inflation shocks, real interest rate shocks, currency shocks, credit defaults and insurance losses. Other systematic returns ('style premia') arise from investor aversion to leverage, volatility, heavily discounted assets, going against the crowd and illiquidity. There is some predictability in longer term asset class returns which tend to revert to a mean.	The Board approves the strategic asset allocation (**SAA**) for each Scheme. SAAs comprise predominantly global bonds and equities. Bond and equity portfolios contain embedded exposure to some of these other risks. SAAs comprise globally diversified portfolios of bonds and equities with moderate foreign currency exposure. Schemes with equity exposure also have exposure to a market neutral portfolio of style premia. The Schemes can only invest in relatively liquid assets. The asset allocation of the Schemes with higher risk tolerance may be varied by management within prescribed limits.

INVESTMENT FACTS	INVESTMENT BELIEFS	INVESTMENT STRATEGY
Asset Class Strategy and Portfolio Structure		
Higher-risk asset classes have higher average returns. Within asset classes, higher risk assets are not always rewarded with higher returns. Most investment strategies are a mixture of exposure to risk premia and active risk from trading strategies based on forecasting returns. Diversified portfolios of securities can be built to capture risk premia without forecasting returns. Investment strategies can be unbundled and emulated in part with derivatives that allow separation of market risk premia from active trading strategies and attribution of their respective costs. Leverage, including the leverage embedded in derivatives, increases the risk of capital loss.	Risk premia that are compensation for risk of loss are expected to persist over time but may fluctuate significantly. Returns derived from investor behaviour or market structure anomalies will persist as long as the behaviour or anomaly persists. Over time, competition is likely to reduce the reward from active strategies and their cost. Leverage should be assessed at a total portfolio level and in relation to the risk and correlation of underlying assets.	Active managers are benchmarked against replicable indexes that reflect the risk factors they attempt to capture. Bond and equity mandates are actively managed where there is sufficient confidence in the ability of available investment managers to add value through security selection. Global equities include a dedicated exposure to low beta stocks. Global bonds and equities include dedicated exposures to emerging markets. Schemes with equity exposure also have exposure to a market neutral portfolio of style premia. Leverage is permissible within strategies where it can be measured and constrained within total portfolio risk limits.

INVESTMENT FACTS	INVESTMENT BELIEFS	INVESTMENT STRATEGY
Manager and Investment Selection		
Markets are competitive and dynamic, varying in depth and the efficiency with which news is reflected in prices. The more efficient a market is, the more difficult it is for a manager to generate returns better than the market persistently.	Some managers can add value by exploiting other systematic risks and anomalies but true skill in generating additional return beyond that is rare. It is challenging but possible to identify superior active managers in certain markets or market segments and to combine them to enhance portfolio risk and return outcomes. Environmental, Social and Governance (**ESG**) factors may affect the performance of companies, securities and investment portfolios representing risks to be managed or opportunities to enhance returns.	All bond and equity mandates are actively managed, i.e. not market-capitalisation weighted. Manager performance is monitored continuously against market benchmarks net of costs to gauge actual active risk and return against expectations. Managers' exposures to systematic market risk and other risk factors are monitored to gauge their skill and the reasonableness of their fees. Managers are combined to avoid concentrated exposures to single risk factors other than market risk as well as manager-specific risks. The Board considers the integration of ESG factors in managers' investment processes and supports integration provided it does not detract value.
INVESTMENT FACTS	**INVESTMENT BELIEFS**	**INVESTMENT STRATEGY**
Execution		
Management fees and implementation costs reduce the net return to investors.		Investments can only be implemented by investing in units of the Global Asset Trust. Manager fees are compared regularly with market peers to ensure they are competitive. Manager performance is monitored continuously against relevant benchmarks and to ensure compliance with mandates. Trading costs of managers are monitored regularly and for all transitions among managers. Schemes' portfolios are rebalanced towards target monthly, trading off performance risk against trading costs.

4.2 Scheme Characteristics and Investment Implications

The Board's primary concern, as trustee of the Schemes, is the financial interests of the members of those Schemes. However, the Board is also concerned with the level of risk its investment activities creates for the Crown under its guarantee of the benefits payable by the Schemes.

Investment returns impact directly on the potential for claims by the Board under the Crown guarantees. As a general guide, any change in asset allocation that reduces the investment risk to the Crown is likely to be at the cost of lower total returns to the members over the longer term.

The Board manages the financial interests of the members of the Schemes, the Crown and employers by setting appropriate investment policies and objectives for all Schemes and through the crediting and reserving policy for the DC Schemes.

4.3 Investment Policies, Objectives and Parameters

The Board determines a Statement of Investment Policies, Parameters and Objectives for each Scheme based on:

- risk and return modelling;
- asset and liability modelling, i.e. consideration of the Scheme's commitment to pay benefits and the relevant time horizon of the Scheme's assets (carried out by a specialist investment adviser); and
- the crediting and reserving policy for the DC Schemes.

The Board also considers the financial interests of NPF's key stakeholders where applicable, namely the members (contributors and pensioners), the employers and the Crown.

The Investment Policies, Parameters and Objectives for the Schemes are attached in *Appendix 1*. The Board reviews these regularly.

4.4 Investment Management Structure

The Schemes are required by the NPF Act to invest only in the GAT and in bank accounts. The GAT consists of separate unit funds comprising different asset classes. The Schemes hold varying exposures to those unit funds in accordance with their individual asset allocations.

4.5 Authorised Investments

Section 4 of the GAT trust deed sets out the investment criteria and obligations of the Board and the Second Schedule of the GAT trust deed sets out the authorised investments of each unit fund. The major assets held by the unit funds are summarised as follows:

Fund Name	Major Assets
Cash Unit Fund €	Cash, debt securities and derivatives products of the asset class with terms less than 12 months
Fixed Interest Unit Fund	Cash, debt securities and derivative products of the asset class
Fixed Interest No.2 Unit Fund	Cash, debt securities and derivative products of the asset class
Overseas Equity Unit Fund	Shares in companies listed on global stock exchanges and units in unit trusts
New Zealand Equity Unit Fund	Shares in companies listed on the New Zealand and Australian stock exchanges
Alternatives Unit Fund	Shares in companies listed on global stock exchanges and units in unit trusts

The Board may amend any of the provisions of the Second Schedule of the GAT trust deed (including asset classes) if, in the opinion of the Board, such amendment, addition or deletion is not materially and adversely prejudicial to the unit holders (the Schemes) in the relevant fund, or with the consent of the unit holders.

4.6 Strategic Asset Allocations

The Board has determined strategic asset allocations for each of the Schemes based on the Schemes' Investment Policies, Parameters and Objectives.

The strategic asset allocations for all Schemes (except the Aircrew Superannuation Scheme and DBP Contributors Scheme) are reviewed every 3-5 years. If a significant deterioration in a Scheme's solvency position develops, more frequent reviews may be initiated.

More frequent reviews are undertaken for the Aircrew Superannuation Scheme and the DBP Contributors Scheme.

The strategic asset allocations are listed in the table below*:

Scheme	Cash Unit Fund %	Fixed Interest Unit Fund %	Fixed Interest No. 2 Unit Fund %	Overseas Equity Unit Fund %	New Zealand Equity Unit Fund %	Alternatives Unit Fund %
Pension National	0	46.5	0	37	9.5	7
Lump Sum National	0	46.5	0	37	9.5	7
Meat Industry	0	46.5	0	37	9.5	7
DBP Contributors	10	90	0	0	0	0
DBP Annuitants	100	0	0	0	0	0
Aircrew Superannuation	0	39.5	39	16	2.5	3
Pension Cash Accumulation	2.5	57.5	0	32	8	0
Lump Sum Cash Accumulation	0	0	78.5	15	3.5	3
National Provident Pension	0	57	0	29.5	7.5	6

* - *last reviewed* 29 August 2018

4.7 Dynamic Asset Allocation (DAA)

From time to time the Schemes' asset allocations may be varied from their strategic asset allocations in response to relative valuation signals. Those positions are expected to add returns over time.

The limits that each asset class and the foreign currency exposure may be tilted away from its strategic allocation for each Scheme is shown in the table below.

	Pension National Scheme, Lump Sum National Scheme and Meat Industry Scheme	Aircrew Scheme, Lump Sum Cash Accumulation Scheme	Pension Cash Accumulation Scheme	National Provident Pension Scheme
Equities/Fixed Interest Exposure (%)	+/-10	0	0	+/-8
Foreign Currency Exposure (%)	+/-10	+/-4.4	+/-8	+/-8
NZ Equities/Global Equities Exposure (%)	+/-2	0	0	+/-2
Cash/Fixed Interest	+/-5	0	0	+/-5

4.8 Rebalancing Policy

To avoid excessive transaction costs by maintaining exact Scheme-specific asset allocations, Schemes' allocations to unit funds are permitted to deviate from their target allocations (which are the Scheme's strategic asset allocations adjusted for any temporary DAA positions) by not more than their respective rebalancing ranges. The ranges are designed to be wide enough to limit transactions costs without compromising the risk and return expected from target allocations.

Schemes' portfolios are rebalanced towards target monthly, trading off performance risk against trading costs.

Rebalancing ranges
(relative to a Scheme's target allocation to a unit fund)

Unit Fund	Rebalancing Range
Cash	+/- 2%
Fixed Interest	+/- 5%
Fixed Interest No.2	+/- 5%
Overseas Equity	+/- 5%
New Zealand Equity	+/- 2%
Alternatives	+/- 2%

4.9 Security Selection

The selection of securities within an asset class is delegated to appointed investment managers. The investment management agreements (**IMAs**), which govern the relationship between the Board and the investment managers, include mandates which detail the investment guidelines (and benchmarks) and any constraints on security selection set by the Board.

5 PERFORMANCE MEASUREMENT

The Board determines long term performance measures for each unit fund and investment manager consistent with the risk, return and diversification assumptions underpinning each asset class. Depending on the investment style for which they are engaged, the investment managers are expected to achieve certain return and risk targets relative to the performance measure for that asset class. The targets are set out in the IMAs with the investment managers.

The performance of individual managers, relative to their performance measure, is reviewed at least quarterly and reviewed in depth at intervals of not more than three years. Returns for short periods (such as quarterly) are monitored as important milestones, but are not necessarily indicative of long term investment performance and are more volatile in nature.

Unit Fund	Unit Fund Performance Measure
Cash	Bloomberg NZBond Bank Bill Index
Fixed Interest	Bloomberg Barclays Global Aggregate Index, hedged fully to New Zealand dollars (NZD)
Fixed Interest No.2	Bloomberg NZBond Swaps 1-3 Year Index
Overseas Equity	MSCI World with Net Dividends Index, hedged 50% (after tax or 69.4% before tax) to NZD
New Zealand Equity	S&P/NZX 50 Gross with Imputation Index
Alternatives	Bloomberg NZ Bond Bank Bill Index

6 VALUATION AND REPORTING

Section 4.5 of the GAT trust deed sets out standards for investment records and sections 4.9 and 4.10 set out the valuation principles for authorised investments.

6.1 Reporting by Investment Managers

The IMAs contain reporting provisions to enable the Board to determine the investment managers' compliance with investment guidelines and other business requirements, and success in meeting the investment return and risk objectives set out in the investment mandates.

The periodic reports by the investment managers cover:

- reviews of the portfolio including performance attribution and portfolio valuations;
- certification that the terms of the IMA have been met;
- reconciliation of portfolio accounts with those of the Board's custodian; and
- a statement of any voting right issues.

6.2 Reporting by the Custodian

The custodian provides monthly reports on each investment manager to the Board to enable monitoring and review of performance.

The reports include:

- investment performance measurement and analysis;
- accounting matters including portfolio valuation;
- reconciliation of portfolio values and cash flows with the investment managers;
- taxation matters; and
- any overdraft position of each portfolio.
- The custodian also certifies to the Board that the terms of the custodian contract have been met.

7 RISK MANAGEMENT

The Board has developed comprehensive risk management policies and procedures covering all aspects of the NPF business.

The Board constantly monitors the operational and financial aspects of NPF's activities and has aligned reviews of the business to the Australia/New Zealand standard AS/NZ ISO 31000:2009. The Audit and Risk Review Committee assists the Board in fulfilling its responsibilities with respect to internal controls, accounting policies, financial statements approval and risk management.

A Management Risk Review Committee meets quarterly and is responsible for recognising, assessing and controlling (either removing or reducing) risks, and reporting to the Audit and Risk Review Committee.

Risk management is further supported by the code of conduct for Board members and Management, Board expenditure policies and procedures, defined roles and responsibilities, individual and collective performance accountability processes, and timely disclosure and communication.

The NPF is a public entity under the Public Audit Act 2001 and therefore within the Auditor-General's mandate. The statutory duties of the auditor are contained in the NPF Act, Financial Reporting Act 1993 and the Financial Markets Conduct Act 2013. Auditing is conducted on an annual basis.

This section provides a high level overview of the standards and procedures adopted by the Board with respect to its investment activities. Extensive and detailed standards and procedures are maintained at an operational level and within the IMAs.

7.1 Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

Operational risk is managed by:

- Management reviewing the analysis of Schemes' liabilities to ensure asset allocations determined for each Scheme remain appropriate;
- the Board engaging an independent custodian to separate the investment function (undertaken by the investment managers) from the transaction settlement, safekeeping, recording and reporting of investment activities (undertaken by the custodian);
- requiring investment managers and the custodian to have in place insurance arrangements to cover claims against operational risks;
- requiring contracted investment managers to have internal policies and controls to address operational risks and regularly confirm their existence and efficiency;
- requiring all investment managers to provide a statement of compliance on a regular basis. Where a breach occurs and the investment manager is at fault, the investment manager is required to report the breach to the Board immediately and make good any loss. Breaches outside the control of the investment manager are required to be reported to the Board in arrears;
- maintaining an effective business continuity plan in conjunction with the custodian and the Schemes' administrator; and
- maintaining a Fraud Minimisation Policy to assist in the identification and mitigation of fraud.

7.2 Liability Risk

Liability risk is the risk that the obligations of the Schemes to pay benefits are valued incorrectly.

Liability risk is managed by:

- an independent actuary (Actuary) valuing the liabilities of the Schemes to pay benefits;
- Management reviewing the assumptions used by the Actuary in valuing the liabilities for reasonableness; and
- Management reviewing the analysis of Schemes' liabilities to ensure the asset allocations determined for each Scheme remain appropriate for its liabilities.

7.3 Investment Risk

Investment risk covers uncertainties in investment returns arising from market risk, credit (and counterparty) risk, liquidity risk, foreign currency risk, derivatives exposure and manager-specific risk. Deciding the level of risk taken in a portfolio is a central function of any organisation charged with the oversight of financial assets.

7.4 Market Risk

Market risk is the risk of adverse movements in asset values due to changes in market conditions.

At a total portfolio level, market risk is managed by:

- adopting a strategic asset allocation for each Scheme consistent with the Scheme's objectives and the nature and time horizon of the Scheme's liabilities;
- limiting the extent to which Scheme asset allocation may be varied pursuant to DAA;
- requiring regular rebalancing of Schemes' asset allocations to their target allocations;
- avoiding concentration of risk by ensuring adequate diversification among and within asset classes and geographically; and
- implementing a comprehensive and robust investment manager evaluation and monitoring process and regularly reviewing the process.

Market risk is further managed by requiring investment managers to manage their portfolios within defined exposure limits. Those limits include (as appropriate):

- limits on the percentage weight of any individual entity in the portfolio relative to its benchmark weight;
- limits on aggregate investment in entities not represented in the benchmark;
- limits on the maximum investment in any individual entity;
- limits relative to the duration of the benchmark; and
- limits on regional and sector weights.

7.5 Credit Risk

Credit risk is the risk of default by a counterparty to a particular transaction or an issuer of a security held in a portfolio. The Board sets guidelines for credit and counterparty risk within individual portfolios and at a consolidated level across all exposures.

Credit risk is managed by requiring that investment managers meet the following mandate guidelines approved by the Board:

- investing only in debt that is rated by an approved, recognised rating agency or unrated debt within the maximum permitted exposure;
- limiting exposure to different levels of credit rating to agreed guidelines; and
- limiting exposure to any one issuer (including derivatives but excluding OECD government and government guaranteed issuers).

7.6 Liquidity Risk

Liquidity risk is the risk that sufficient securities cannot be sold to meet required cash flows or that the price achieved is significantly less than the last valuation.

The choice and mix of assets invested in are undertaken with a view of providing sufficient liquidity to enable the Schemes to meet all of their future obligations as they become payable. A major consideration for the Board is the declining asset base, as the Schemes mature, and the effect of this on liquidity requirements and the most suitable investment structure. Investments are selected with consideration given to their effect on liquidity risk as well as the return to be derived.

Liquidity risk is managed by:

- investing primarily in securities traded on recognised exchanges with specified maxima for unlisted securities;
- ensuring a sufficient proportion of the Scheme's assets is invested in securities that can be realised in a timely manner without excessive risk of price discounting; and
- ensuring that margin and settlement requirements of derivative positions are fully collateralised by liquid assets.

7.7 Foreign Currency Risk

Foreign currency risk is the risk the foreign currency denominated assets will lose value due to the effect of an adverse exchange rate movement.

Foreign currency risk is managed by:

- establishing a foreign currency hedging policy for each international asset class appropriate to the Schemes investing in the asset class; and
- specifying the bounds within which each investment manager may take on currency exposures relative to their benchmark.

The Board's foreign currency hedging policies are:

Overseas equities
The Board reduces foreign currency exposure associated with the overseas equities portfolio through foreign currency hedging contracts. The target hedging ratio to the New Zealand dollar (**NZD**) is 50% after tax of the portfolio. The hedge ratio may be varied with approval by the Board.

International fixed interest
Foreign currency exposures arising from investment in international fixed interest are hedged fully (100%) to the NZD.

Implementation
Foreign currency positions are managed passively with respect to the NZD, while international fixed interest and overseas equities managers may take positions on other currencies within agreed bounds.

The instruments that managers may use, and the credit worthiness of the counterparties, are detailed in the IMAs with respective managers.

Any forward contracts entered into must be with entities that have an appropriate minimum credit rating, as determined by an international credit rating agency, for counterparty risk, and appropriate contractual arrangements (for example, an ISDA Agreement) must be in place between the investment manager and the counterparty.

7.8 Derivatives Exposure

Derivatives are financial instruments whose value is derived from, or linked to, the value of an underlying security, or index that represents either direct ownership of an asset or the direct obligation of an issuer, otherwise known as the physical instrument. Derivatives include a wide assortment of instruments such as futures, swaps, forwards, warrants and all forms of options.

The objective of derivatives usage is to facilitate risk management and to promote efficiency in the implementation of investment strategy. The use of derivatives is subordinate to the investment strategy and must be consistent with the objectives of the investment strategy.

The following derivative instruments may be used:

- derivative instruments traded on recognised exchanges; and
- over-the-counter derivative agreements, subject to the counterparty having a minimum credit rating by an approved, recognised rating agency.

Appropriate contractual arrangements (for example, an ISDA master agreement) must be in place between the investment manager (or, as the case may be, the Board) and the counterparty in a form satisfactory to the Board.

Investment managers are also required to have in place appropriate risk management policies and procedures, in a form satisfactory to the Board. Each investment manager must provide the Board with a copy of its current policies relating to derivatives usage and manage its derivative exposures in accordance with those policies.

The use of derivatives may include the following:

- to manage risk or hedge against movements in interest rates, values or prices in relation to permitted investments and movements in foreign currency exposures;
- to achieve or reduce exposure to assets, all or part of any asset class and foreign currency; and
- to achieve transactional efficiency or reduce the transactional cost of achieving required exposures.

Obligations pursuant to derivative contracts must be collateralised sufficiently. This means the GAT must hold sufficient cash or securities to fully satisfy any claims arising from derivative positions at current and prospective market prices and ensure the GAT or Scheme remains within permitted risk limits at all times.

Derivative contracts are valued using a mark-to-market methodology unless otherwise specifically approved. The effective duration or credit exposure of any derivative positions will be taken into account when determining compliance with the duration limits of fixed interest portfolios and determining compliance with portfolio exposure limits.

7.9 Manager Specific Risk

The Board regularly monitors each investment manager’s performance against clearly-defined investment mandates and objectives. Contracts with investment managers may be terminated without cause at a maximum of 30 days’ notice, unless otherwise approved by the Board.

8 RESPONSIBLE INVESTMENT

8.1 Voting Guidelines and Good Corporate Governance

The Board, as trustee of the GAT, holds securities in a number of New Zealand and international companies. As an owner of securities, the Board is committed to encouraging companies to adopt good corporate governance and disclosure practices.

8.2 New Zealand Securities

Investment managers are delegated authority by the Board to exercise voting rights. In general, voting by the managers should be in accordance with the guidelines and recommendations of a recognised proxy voting service. If the investment manager does not intend to vote in accordance with recommendations of the proxy voting service, they must advise the Board.

The Board may direct an investment manager how to vote if the investment manager has a different view on an issue from that recommended by the proxy voting service or where there are conflicting views among the investment managers on the same issue.

8.3 Other Securities

Investment managers are delegated authority by the Board to exercise voting rights in the best interests of Schemes' members.

The Board retains the ultimate right to exercise all voting rights.

8.4 Excluded Investments

The Board may take into consideration whether any investment would be:

- contrary to New Zealand law, if conducted in New Zealand;
- contrary to international law or to international treaties to which New Zealand is a party, particularly those relating to international security and disarmament and human rights;
- involved in severe environmental damage, serious human rights abuses or bribery and corruption as identified by independent research by the Guardians of New Zealand Superannuation;

provided that taking those factors into consideration does not conflict with its legal and fiduciary duties as trustee of the Schemes and can be implemented in a practicable and cost effective way.

The Board publishes a list of its excluded investments on its website.

8.5 Pooled Investments

Investment in a commingled investment vehicle (**CIV**) may be a practicable and cost effective way of achieving exposure to some investment markets. The Board will have no influence or control over the structure of the CIV, the corporate securities held by it or individual voting decisions of the CIV's manager.

In applying its ESG policies to a CIV, the Board assesses value to the Fund of the CIV as a whole rather than each security it may hold. The Board takes into account a CIV's approach to ESG issues, communicates its own ESG policies to managers of CIVs in which it invests and encourages them to consider whether its policies are appropriate for the CIV. In addition, the Board may review its investment if there is a material change in the CIV's mandate or strategy.

9 APPENDICES

9.1 Appendix 1 - Statement of Investment Policies, Parameters and Objectives by Scheme

PENSION NATIONAL SCHEME, LUMP SUM NATIONAL SCHEME AND MEAT INDUSTRY SCHEME

Investment Policies

1. The Board's trustee responsibilities under common law and statute must be met.
2. Investment decisions will be made on an after-tax basis and, whenever practical, tax will be minimised.
3. Reserves will be maintained at an appropriate level to provide for the payment of the 4% minimum earnings rate.
4. Investment risk will be minimised for the expected level of return.
5. An appropriate level of diversification across securities, sectors, asset classes and countries will be maintained.
6. Assets will be managed with liquidity requirements in mind.
7. The Schemes will not be leveraged at any time.
8. Flexibility will be accommodated to allow for changes in the Schemes' requirements and investment environment.
9. All aspects of the investment process will be reviewed regularly, including, but not limited to:
   - quarterly reporting of investment results and benchmarks;
   - quarterly comparison of manager results with peers;
   - annual reviews of investment managers; and
   - three-yearly reviews of investment policies, objectives and strategies.

Investment Parameter

That there is not more than one chance in two that after five years the Scheme will be in deficit, in the sense that the contributors' total credits exceed the corresponding assets.

Investment Objective

To achieve an average investment return of not less than 4% p.a., net of tax and expenses during the next ten years. This is the minimum earnings rate set out in the Scheme trust deed.

Investment Policies

1. The Board's trustee responsibilities under common law and statute must be met.
2. Investment decisions will be made on an after-tax basis and, whenever practical, tax will be minimised.
3. Investment risk will be minimised for the expected level of return.
4. An appropriate level of diversification across securities, sectors, asset classes and countries will be maintained.
5. Assets will be managed with liquidity requirements in mind.
6. The Scheme will not be leveraged at any time.
7. Flexibility will be accommodated to allow for changes in the Scheme's requirements and investment environment.
8. All aspects of the investment process will be reviewed regularly, including, but not limited to:
    - quarterly reporting of investment results and benchmarks;
    - quarterly comparison of manager results with peers;
    - annual reviews of investment managers; and
    - three-yearly reviews of investment policies, objectives and strategies.

Investment Parameters

The Strategic Asset Allocation will be chosen to ensure that:

1. There is no more than a 1 in 10 chance of the Required Gross Subsidy Rate exceeding 2.5% after five years.
2. The volatility in surplus at termination is minimised.
3. There is not more than a one in four chance of the Past Service Coverage Ratio falling below 100% after five years.

Investment Objective

To maximise the investment return, after tax and expenses, in excess of the discount rate used by the Actuary to value the liabilities, over the next five years, subject to the Investment Parameters.

Definitions

Past Service Coverage Ratio *- the net value of the Scheme's assets divided by the actuarial value of past service liabilities.*

Required Gross Subsidy Rate *- the before-tax employer contribution rate, expressed as a proportion (multiple) of the employee contribution rate.*

Investment Policies

1. The Board's trustee responsibilities under common law and statute must be met.
2. Investment decisions will be made on an after-tax basis and, whenever practical, tax will be minimised.
3. Investment risk will be minimised for the expected level of return.
4. Assets will be managed with liquidity requirements in mind.
5. The Scheme will not be leveraged at any time.
6. Flexibility will be accommodated to allow for changes in the Scheme's requirements and investment environment.
7. All aspects of the investment process will be reviewed regularly, including, but not limited to:
    - quarterly reporting of investment results and benchmarks;
    - quarterly comparison of manager results with peers;
    - annual reviews of investment managers; and
    - three-yearly reviews of investment policies, objectives and strategies.

Objective

To achieve regular income flow sufficient to meet, at least, the expenses of the Scheme.

AIRCREW SUPERANNUATION SCHEME

Investment Policies

1. The Board's trustee responsibilities under common law and statute must be met.
2. Investment decisions will be made on an after-tax basis and, whenever practical, tax will be minimised.
3. Investment risk will be minimised for the expected level of return.
4. An appropriate level of diversification across securities, sectors, asset classes and countries will be maintained.
5. Assets will be managed with liquidity requirements in mind.
6. The Scheme will not be leveraged at any time.
7. Flexibility will be accommodated to allow for changes in the Scheme's requirements and investment environment.
8. All aspects of the investment process will be reviewed regularly, including, but not limited to:
    - monthly reporting of investment results and benchmarks;
    - quarterly comparison of manager results with peers;
    - annual reviews of investment managers; and
    - three-yearly reviews of investment policies, objectives and strategies.

Investment Parameters

The Strategic Asset Allocation will be chosen to ensure that:

1. There is no more than a one in 20 chance that in five years' time the Past Service Coverage Ratio will be less than 90%.
2. There is no more than one chance in 10 that the Required Gross Subsidy Rate required in five years' time will be greater than three times the contributors' contributions.

Investment Objective

To maximise the investment return, after tax and expenses, in excess of the discount rate used by the Actuary to value the liabilities, over the next five years, subject to the Investment Parameters.

Definitions

Past Service Coverage Ratio *- the net value of the Scheme's assets divided by the actuarial value of past service liabilities.*

Required Gross Subsidy Rate *- the before-tax employer contribution rate, expressed as a proportion (multiple) of the employee contribution rate.*

PENSION CASH ACCUMULATION SCHEME

Investment Policies

1. The Board's trustee responsibilities under common law and statute must be met.
2. Investment decisions will be made on an after-tax basis and, whenever practical, tax will be minimised.
3. Reserves will be maintained at an appropriate level to provide for the payment of the 4% minimum earnings rate.
4. Investment risk will be minimised for the expected level of return.
5. An appropriate level of diversification across securities, sectors, asset classes and countries will be maintained.
6. Assets will be managed with liquidity requirements in mind.
7. The Scheme will not be leveraged at any time.
8. Flexibility will be accommodated to allow for changes in the Scheme's requirements and investment environment.
9. All aspects of the investment process will be reviewed regularly, including, but not limited to:
    - quarterly reporting of investment results and benchmarks;
    - quarterly comparison of manager results with peers;
    - annual reviews of investment managers; and
    - three-yearly reviews of investment policies, objectives and strategies.

Investment Parameter

To maximise the expected level of investment earnings allocated to contributors' total credits subject to the following constraint:

That there is not more than one chance in three that after five years the Scheme will be in deficit, in the sense that the contributors' total credits exceed the corresponding assets.

Investment Objective

To achieve an average return of not less than 4% p.a., net of tax and expenses, during the next ten years. This is the minimum earnings rate set out in the Scheme trust deed.

LUMP SUM CASH ACCUMULATION SCHEME

Investment Policies

1. The Board's trustee responsibilities under common law and statute must be met.
2. Investment decisions will be made on an after-tax basis and, whenever practical, tax will be minimised.
3. Reserves will be maintained at an appropriate level to provide for the payment of the 4% minimum earnings rate.
4. Investment risk will be minimised for the expected level of return.
5. Assets will be managed with liquidity requirements in mind.
6. The Scheme will not be leveraged at any time.
7. Flexibility will be accommodated to allow for changes in the Scheme's requirements and investment environment.
8. All aspects of the investment process will be reviewed regularly, including, but not limited to:
    - quarterly reporting of investment results and benchmarks;
    - quarterly comparison of manager results with peers;
    - annual reviews of investment managers; and
    - three-yearly reviews of investment policies, objectives and strategies.

Investment Parameter

To achieve sufficient returns to meet the 4% per annum minimum earnings rate.

Investment Objective

To achieve an average investment return of not less than 4% p.a., net of tax and expenses, over the next seven years subject to a high level of liquidity being maintained.

The Scheme is required to have a high level of liquidity to meet entitlements as they fall due. The entitlements are not predictable and are subject to member election.

Investment Policies

1. The Board's trustee responsibilities under common law and statute must be met.
2. Investment decisions will be made on an after-tax basis and, whenever practical, tax will be minimised.
3. Investment risk will be minimised for the expected level of return.
4. An appropriate level of diversification across securities, sectors, asset classes and countries will be maintained.
5. Assets will be managed with liquidity requirements in mind.
6. The Scheme will not be leveraged at any time.
7. Flexibility will be accommodated to allow for changes in the Scheme's requirements and investment environment.
8. All aspects of the investment process will be reviewed regularly, including, but not limited to:
    - quarterly reporting of investment results and benchmarks;
    - quarterly comparison of manager results with peers;
    - annual reviews of investment managers; and
    - three-yearly reviews of investment policies, objectives and strategies.
9. The Board will determine the minimum solvency ratio to be maintained in the Scheme. When the solvency ratio exceeds the minimum level, consideration will be given by the Board to pension increases. The minimum solvency ratio approved by the Board is 110%.

Investment Parameters

To maximise the expected returns on the Scheme's assets and hence the likelihood of improving the actuarial solvency subject to the constraint that there be not more than 1 chance in 3 that the solvency ratio will be less than 80% after five years.

Investment Objective

To maximise the investment return, after tax and expenses, in excess of the discount rate used by the Actuary to value the liabilities, over the next five years, subject to the Investment Parameters.