

**Board of Trustees
of the
National Provident Fund**

**STATEMENT OF
INVESTMENT
POLICIES AND
OBJECTIVES**

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PURPOSE

Preface

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 were closed to new members in 1991.

This Statement of Investment Policies and Objectives (**SIPO**) records the framework set by the Board of Trustees of the National Provident Fund (the **Board**) for the governance and management of the investment assets held on behalf of the NPF Schemes. The Board's governance framework is designed to establish good decision-making processes, clearly define fiduciary roles and responsibilities, and to provide effective policies and procedures for management of the investment assets of the NPF Schemes.

The SIPO contains policies and objectives relating to the investment of the assets held on behalf of the NPF Schemes. Its contents are set out under the following headings:

- Overview
- Governance
- Portfolio management (including investment principles and scheme objectives)
- Performance measurement
- Valuation and reporting
- Risk management
- Voting

Amendments to this document (and previous amendments) are recorded in a version control document called "NPF SIPO Amendments".

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

Review of Statement of Investment Policies and Objectives

The SIPO is reviewed periodically and in any event at no less than 12 monthly intervals.

OVERVIEW

Legislative framework

The governing legislation for NPF is the National Provident Fund Restructuring Act 1990 (the **NPF Act**). The Board is also bound by the Superannuation Schemes Act 1989, KiwiSaver Act 2006, Public Finance Act, Income Tax Act, the Trustee Act 1956 (except in relation to the investment of funds in respect of the trust deed for an existing scheme (being an NPF Scheme) or the investment of the property of the scheme¹), 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 NPF Schemes.

Under the NPF Act, the Board is trustee of the now 11 NPF Schemes and the Global Asset Trust (the **GAT**). The GAT holds the investment assets on behalf of the NPF Schemes. Section 53 of the NPF Act provides that the NPF Schemes may be invested only in the GAT.

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 NPF Schemes.

Crown guarantee

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

The trust deeds for NPF's defined contribution and cash accumulation schemes provide for a minimum earnings rate of 4% (net of tax) per annum. Under section 72 of the NPF Act, where a deficiency (or increase in deficiency) arises as a consequence of the application of the 4% 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.

Nature of the NPF Schemes

Each NPF Scheme has its own trust deed.

There are currently 11 NPF Schemes plus the GAT which (in terms of the NPF Act) is also a superannuation scheme. The NPF Schemes are listed below according to the 4 scheme types.

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

- ***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
Annual Single Premium Scheme
Level Premium Scheme

- ***Cash Accumulation Schemes***
Pension Cash Accumulation Scheme
Lump Sum Cash Accumulation Scheme

- ***National Provident Pension Scheme***

Funding of the defined benefit schemes

DBP Contributors Scheme and Aircrew Superannuation Scheme

Actuarial valuations for the DBP Contributors Scheme and the Aircrew Superannuation Scheme are required, under section 68 of the NPF Act, to be completed at a minimum of every three years. The actuarial valuations are used to determine the employer contribution rate required to fund the benefits payable by the schemes. Current Board policy is to complete annual actuarial reviews for these two schemes.

Employers are obliged to contribute to these two schemes as long as the employees 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 and the Government Actuary.

Old Public Fund Schemes

The member contribution rates for the two Old Public Fund Schemes are set out in the trust deeds for each of the schemes. There is no explicit employer subsidy.

Crediting and reserving policy, and member benefits

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 earnings in good investment years are held in reserve by the DC schemes to support both the minimum earnings rates and their ability to pay 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% per annum, and
- when the scheme reserves fall short of the target, the earnings rate is $4\% + \text{reserve level/target reserve level (10\%)} \times (\text{actual investment return} - 4\%)$, subject to a minimum of 4% and a maximum of the actual investment return.

Pension increases

Pension increases for members of the National Provident Pension Scheme and Old Public Fund Schemes are at the discretion of the Board. Exercise of the discretion is based on the advice of the Actuary. A key factor taken into account by the Board, in considering whether to approve an increase in the pensions, is the solvency position of each scheme.

GOVERNANCE

Responsibilities of the Board

The Board is responsible for making all decisions relating to the business of the 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 NPF Schemes, the Board is responsible for:

- determining investment policies, objectives and parameters for the NPF Schemes;
- determining and implementing asset allocation strategies for the NPF 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.

The Board maintains a high standard of governance in administering the NPF Schemes and the GAT. In setting the investment policies, objectives and parameters, the Board will act in the best financial interests of the members of the NPF Schemes, while taking into account the interests of the Crown as guarantor of the benefits payable by the NPF Schemes.

Within 6 months after the end of each financial year, the Board sends to the Minister:

- the annual reports for each of the NPF Schemes, the GAT and the GAT subsidiaries and the Board,
- the actuarial valuations completed with respect to the NPF Schemes, and
- the report required by Section 67 1(A) of the NPF Act covering:
 - scheme asset allocations and scheme investment performance,
 - the investment performance of the separate classes of assets,
 - the allocation of costs to existing schemes, and
 - any changes in the actuarial basis for valuing scheme liabilities.

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

Board objectives

The Board's primary concern, as trustee, is the financial interests of the members of the schemes. The Board has set the following objectives:

The Board will act in the best financial interest of members, taking into account the interests of the Crown as guarantor, by:

SCHEME RETURNS

Optimising investment returns (within acceptable risk parameters) 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.

Delegations and decision making framework

The Board's governance is designed to establish good decision-making processes, clearly define fiduciary roles and responsibilities, and to provide effective policies and procedures for management of the NPF 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
	<i>Schemes Objectives, Policies and Risk Parameters and Strategic Asset Allocation</i>	<i>Active/Passive, Asset Class Strategy and Structure</i>	<i>Manager Selection</i>	<i>Implementation</i>	<i>Security Selection</i>	<i>Review for Compliance v. Objectives</i>
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)	Recommendations sought as required					Reviews Investment Managers for primary asset classes
Custodian					Settles transactions	Independent calculation of investment managers returns
Investment Managers					Decides	Investment mandates and guidelines/ monthly certification

Responsibilities of the Investment Committee

Under the NPF Act, the Board may establish committees and delegate to any such committee all or any of its powers. Each committee operates under terms of reference approved by the Board and is reviewed regularly. The Chairman of the Board is an ex officio member of each committee.

The Board has established an Investment Committee to assist the Board in the following ways:

- lead Board discussion on matters relating to the investment policies and objectives, risk management and investment manager, custodian or investment adviser appointments, review and terminations,
- be available to Management for discussion during Management's development of investment related proposals for submission to the Board,

- review the investment manager evaluation and monitoring process to ensure it remains comprehensive, robust and best practice, at least annually,
- provide an open avenue of communication between the Board and the investment adviser, noting that the day to day relationship between the investment adviser and the Board will be through Management, and
- consider Management's recommendations of action to be taken regarding the Board's policies on maximum exposure to New Zealand entities and any voting referrals received from investment managers.

Responsibilities of Management

The Board and the Government Superannuation Fund Authority have formed a joint venture company, Annuitas Management Limited (**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 operate under delegated authorities from the Board, as set out in the Management Services Agreement. The Board reviews the delegations on a regular basis. In addition, the Board has appointed the Chief Executive and the Board Secretary as its attorneys. 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 and strategy,
- 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.

PORTFOLIO MANAGEMENT

The Board seeks to optimise investment returns within acceptable risk parameters and while controlling costs.

Investment principles

To provide a robust conceptual foundation for its investment policies and objectives and to communicate shared values about investment, the Board has agreed a set of Investment Principles, summarised below:

- Higher expected returns are generally associated with higher risks as capital markets are fairly efficient in pricing risks.
- Achieving the Board's scheme return objectives generally requires acceptance of investment risk beyond holding risk free liquid assets.
- Portfolio diversification reduces risk. Holding a range of lowly correlated assets and exposures to different risk premia is the surest way to achieve more reliable outcomes over time.
- Setting the asset allocation policy is the biggest driver of risk and expected return and should incorporate the widest practicable range of risk premia.
- Short term returns from risky assets are largely random. There is a greater degree of predictability around longer term returns, however, and current pricing matters. Markets are not always well-behaved statistically and are prone to extreme outcomes (booms and busts) from time to time.
- Markets vary in their depth and efficiency offering skilful managers the opportunity to add value by exploiting temporary mispricing. While the sum of the returns from all active management is theoretically zero, it is possible to identify superior active managers and combine them to enhance investment performance. But this requires the application of skill and resources.
- Environmental, social and governance factors may be incorporated into the investment process, where supported by a robust business case. The Board's policy statement titled "Environmental, Social and Governance Factors (**ESG**) and the Investment Process" is available on the website www.npf.co.nz.
- Control of costs is important. The returns from investment activity should be considered net of all relevant costs.

Scheme characteristics and investment implications

The Board's primary concern, as trustee of the NPF 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 create for the Crown under its guarantee of the benefits payable by the NPF Schemes.

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. Investment returns directly impact on the potential for claims by the Board under the Crown guarantee.

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

Investment policies, objectives and parameters

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

- risk and return modelling;
- asset and liability modelling ie 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, objectives and parameters for the NPF Schemes are attached in Appendix 2. The Board reviews these regularly.

Investment management structure

The NPF Schemes are required by the NPF Act to invest only in the GAT and in bank accounts. The GAT is divided into separate unit funds representing various asset classes. The NPF Schemes purchase units in accordance with their asset allocations.

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 as at December 2009 are summarised as follows:

Fund Name	Major Assets
Overseas Equity Unit Fund	Shares in companies listed on stock exchanges and units in unit trusts which hold shares in companies listed on stock exchanges.
New Zealand Equity Unit Fund	Shares in companies listed on the New Zealand Stock Exchange
Property Unit Fund	Shares in international property vehicles listed on stock exchanges and units in a trust that invests in New Zealand property
Fixed Interest Unit Fund	Cash, debt securities and derivative products of the asset class
Cash Unit Fund	Cash, debt securities and derivatives products of the asset class with terms less than 12 months.
Commodities Unit Fund	Collateralised commodity futures or investment in a vehicle where the performance is related to commodities.
Fixed Interest No.2 Unit Fund	Cash, debt securities and derivative products of the asset class

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 NPF Schemes) in the relevant fund, or with the consent of the unit holders.

Strategic asset allocations

The Board has determined strategic asset allocations for each of the NPF Schemes based on schemes investment policies and objectives. The allocation to each unit fund (or asset class) provides in total the risk/return trade off given an acceptable risk level set for the scheme.

The strategic asset allocations for the NPF Schemes are set out in *Appendix 1*.

Asset allocation is managed passively. No attempt is made to add value by actively over-weighting or under-weighting particular asset classes at the expense of others.

The Board's policy is to review the strategic asset allocations for all NPF Schemes (except the Aircrew Superannuation Scheme and DBP Contributors Scheme) every 3-5 years. If a significant deterioration in a scheme's solvency position develops, more frequent reviews are usually initiated. For the Aircrew Superannuation Scheme and the DBP Contributors Scheme, annual reviews are undertaken.

Rebalancing policy

To avoid excessive transaction costs that may arise through maintaining scheme specific asset allocations, the allocations are permitted to vary within specified

ranges. The ranges are designed to be wide enough to minimise transactions costs but not so wide as to compromise the benchmark allocations.

The Board's policy is to rebalance the assets of the NPF Schemes (within ranges) to the strategic asset allocations on a monthly basis.

Security selection

The selection of assets 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 benchmark indices) and any constraints on security selection set by the Board.

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
Overseas Equity Unit Fund	MSCI World ex Australia with net dividends reinvested, hedged 50% (after tax or 71% before tax) into New Zealand dollars (NZD).
New Zealand Equity Unit Fund	NZX50 Gross Return with Imputation Credits Index.
Property Unit Fund	FTSE EPRA/NAREIT Global Real Estate Index Total Return hedged 50% (after tax or 71% before tax) to NZD.
Fixed Interest Unit Fund	The Barclays Capital Global Aggregate Index fully hedged to NZD
Cash Unit Fund	NZX New Zealand 90 day Bank Bill Index.
Commodities Unit Fund	Dow Jones AIG Commodities Total Return Index fully hedged to NZD
Fixed Interest No.2 Unit Fund	ANZ Short End Swap Index

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.

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 investment management agreement have been met;
- reconciliation of portfolio accounts with those of the Board's custodian; and
- a statement of any voting right issues.

Reporting by the custodian

The custodian provides 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 certifies to the Board that the terms of the custodian contract have been met.

RISK MANAGEMENT

Risk management environment

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 4360 1999. An Audit & Risk Review Committee assists the Board in fulfilling its responsibilities with respect to internal controls, accounting policies, financial statements approval and risk management.

Risk management is further supported by the conduct policies 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.

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 investment management agreements.

Operational risk

Operational risk is the risk of financial loss due to mismanagement, error, fraud or unauthorised use of techniques and/or financial products.

Operational risk is managed by:

- Management analysing the schemes liabilities to ensure that asset allocations determined for each scheme remain appropriate;
- the Board engaging an independent global 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 provide the Board with third party covenants or assurances against certain operational risks and to have in place insurance arrangements to cover claims in those events;
- requiring contracted investment managers to have in place, and regularly confirm the existence and efficiency of, internal policies and controls to address operational risks;
- the Board regularly monitoring individual investment manager's performance against clearly defined investment mandates and objectives. Contracts with investment managers can be terminated without cause at a maximum of 30 days notice;

- requiring all managers (investment managers and other contractors and advisers) to provide a statement of compliance on a regular basis. Where a breach occurs and the manager is at fault, the manager is required to report the breach to the Board immediately and make good any loss. Breaches outside the control of the manager are required to be reported to the Board in arrears;
- establishing a Management Risk Review Committee responsible for recognising, assessing and controlling (either removing or reducing) operational risk;
- establishing an effective business continuity plan in conjunction with the custodian and the schemes administrator; and
- the Board adopting a Fraud Minimisation Policy to assist in the identification and mitigation of fraud.

The NPF entities are public entities under the Public Audit Act 2001 and therefore come within the Auditor-General's mandate. The statutory duties of the auditor are contained in the NPF Act, Financial Reporting Act 1993 and the Superannuation Schemes Act 1989. Auditing is conducted on an annual basis.

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.

Market risk

Market risk is the risk of adverse movements in an investment market (including asset prices, volatility, changes in the yield curve or other market related variables).

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;
- avoiding concentration of risk by ensuring adequate diversification between 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.

Credit risk

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

Credit risk is managed by requiring that investment managers of global and New Zealand fixed interest meet the following mandate guidelines:

- debt of all entities in which the manager invests is either rated by an approved recognised rating agency or, if it is not-rated, is constrained to the maximum permitted exposure;
- the credit quality within the manager's portfolio is within minimum guidelines;
- exposure to different levels of credit are within agreed guidelines; and
- the maximum permitted exposure to any one issuer is within agreed guidelines.

Liquidity risk

Liquidity risk is the risk that a security cannot be sold when required or that the price achieved is significantly different from the quoted price.

The choice and mix of assets invested in are undertaken with a view of providing sufficient liquidity to enable the NPF 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 NPF 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 within the context of the investment portfolio 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;
- requiring managers, within the terms of their individual contracts, to hold diversified portfolios; and

- limiting the credit rating of all fixed interest investments to minimum levels.

Foreign currency risk

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

Currency risk is managed by:

- establishing a foreign currency hedging policy for each international 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:

International equities and Property

The Board reduces foreign currency exposure associated with the international equities and property portfolios through foreign currency hedging contracts. From 30 June 2008 the target hedging ratio to the New Zealand dollar (NZD) is 50% (after tax or 71% before tax) of the size of the relevant portfolio. Prior to 30 June 2008 the hedge ratio was 100% after tax.

International fixed interest and commodities

Foreign currency exposures arising from investment in international fixed interest and commodities are fully hedged to the NZD.

Foreign currency positions are managed passively with respect to the NZD while international fixed interest 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.

Derivatives exposure

Derivatives are financial instruments whose value and marketability is derived from, or linked to, the value of an underlying security, commodity, 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 and include 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 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.

Recent mandates awarded have included the requirement for the investment manager to have in place appropriate risk management policies and procedures, in a form satisfactory to the Board. Each manager is required to provide the Board with a copy of its current policies relating to derivatives usage and to 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.

Derivative contracts held 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.

VOTING

Voting Guidelines and good corporate governance

The Board, as trustee of the Global Asset Trust, will hold shares in a number of New Zealand and international companies. As an owner of shares, the Board is committed to encouraging companies to adopt good corporate governance and disclosure practices.

The Board achieves this by engaging a proxy voting service (Institutional Shareholder Services Pty Limited (ISS)) and by adopting the corporate governance principles (ISS Proxy Voting Guidelines) developed by ISS, and by exercising voting rights attached to securities directly held in the Board's portfolios. In general the Board will support proposals that reflect good corporate governance practice and are in the NPF Schemes members' interests. Where the ISS assessment is that the voting proposal does not meet good corporate governance practice and/or is not in the members' interests, the Board will generally oppose the proposal.

New Zealand Equities

Investment managers will be delegated authority by the Board to exercise voting rights in accordance with their judgement of what is in the best interests of the members. In general, voting by the managers will be in accordance with the ISS Proxy Voting Guidelines.

The Board retains the ultimate right to exercise voting rights.

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

Pooled Investments

Investment in a pooled investment product (product) 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 product, the corporate securities held by the product or individual voting decisions of the product.

Appendix 2

NPF SCHEMES Investment Policies and Objectives by Scheme

DBP CONTRIBUTORS SCHEME

Statement of 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.

Parameters

The Strategic Asset Allocation will be chosen to ensure that:

1. There is no more than **1 chance in 20** that in **5** years time the Required Gross Subsidy Rate exceeds **2.5** times contributor contributions.
2. The volatility in surplus at termination is minimised.
3. There is not more than **1 chance in 10** that in **5** years time the Past Service Coverage Ratio falls below **100%**.

Investment Objective

To achieve an after tax investment return in excess of the NZX Government Stock index, after tax and expenses, over the next **5** years.

Strategic Asset Allocation

DBP Contributors	Cash (%)	Fixed Interest (%)	New Zealand Equity %	Overseas Equity %	Property (%)	Commodities (%)	Fixed Interest No 2 (0%)
	20	70	1.5	6.0	2.5	0	0

AIRCREW SUPERANNUATION SCHEME

Statement of 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.

Parameters

To minimise the long term cost to the employer subject to the following constraints:

1. There is no more than **1 chance in 10** that in 5 years time the Past Service Coverage Ratio will be less than **90%**.
2. There is no more than **1 chance in 20** that in 5 years time the Gross Subsidy Rate required will be greater than **3.0** times the contributor's contributions.

Investment Objective

To achieve a return in excess of the NZX Government Stock Index, after tax and expenses, over the next **7** years.

Strategic Asset Allocation effective from 1 April 2008

Aircrew	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	0	58	6.5	25	7.5	3	0

DBP ANNUITANTS SCHEME

Statement of 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:
 - 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 Objective

The assets of the DBP Annuitants Scheme available to meet benefit payments were fully depleted by May 2009. The benefits are now supported by calls on the Crown guarantee.

The overriding investment objective is to achieve regular income flow for the Scheme, sufficient to meet the expenses of the Scheme.

Strategic Asset Allocation effective from 1 April 2008

DBP Annuitants	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	100	0	0	0	0	0	0

NATIONAL PROVIDENT PENSION SCHEME

Statement of 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.

Parameters

1. 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 Board has approved a minimum solvency ratio of **108%**.
2. The objective of the investment policy of the Scheme is to maximize the expected returns on the assets subject to the constraint that there is not more than **1 chance in 5** that in 5 years time the solvency ratio will be less than **100%**.

Note: the constraint of 1 chance in 5 (in red) on the probability of solvency was set in May 1999 and reconfirmed in May 2003.

Investment Objective

To achieve an annual average return of not less than **4%**, net of tax and expenses during the next **5** years. This is the discount rate used by the Actuary to value the liabilities of the Scheme.

Strategic Asset Allocation effective from 1 April 2008

National Provident Pension	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	10	58	4	17.5	7.5	3	0

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

Statement of 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:
 - 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.

Parameters

1. That there is not more than **1 chance in 20** that in 5 years time the Scheme will be in deficit, in the sense that the contributors' total credits exceed the corresponding assets.
2. That the expected funds exchanged between retiring contributors and remaining contributors be less than **2.5%** of contributors' total credits during the next **5** years.

Investment Objective

To achieve an annual average return of not less than **4%**, net of tax and expenses during the next **5** years. This is the minimum earnings rate set out in the Scheme trust deed.

Strategic Asset Allocation effective from 1 April 2008

Pension National/ Lump Sum National Scheme and Meat Industry Scheme	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	10	58	4.0	17.5	7.5	3.0	0

PENSION CASH ACCUMULATION SCHEME

Statement of 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:
 - 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.

Parameters

To maximise the expected level of investment earnings allocated to Contributors' Total Credits subject to the following constraints:

1. That there is not more than **1 chance in 20** that in 5 years time the Scheme will be in deficit, in the sense that the contributors' total credits exceed the corresponding assets.
2. That the expected funds exchanged between retiring contributors and remaining contributors be less than **2.5%** of contributors' total credits during the next **5** years.

Investment Objective

To achieve an annual average return of not less than **4%**, net of tax and expenses during the next **5** years. This is the minimum earnings rate set out in the Scheme trust deed.

Strategic Asset Allocation effective from 1 April 2008

Pension CAS	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	10	58	4	17.5	7.5	3	0

LUMP SUM CASH ACCUMULATION SCHEME

Statement of 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:
 - 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.

Parameter

1. To achieve sufficient returns in order to meet the 4% minimum earnings rate.;

Investment Objective

To achieve a an annual average return of not less than **4%**, net of tax and expenses, over the next **7** 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.

Strategic Asset Allocation

Lump Sum CAS	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	0	0	0	0	0	0	100

ANNUAL SINGLE PREMIUM

Statement of 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.

Parameters

The investments objectives for the Annual Single Premium Scheme are to:

1. Maintain the asset liability ratio above 100%.
2. Mitigate the risk of any deterioration in the asset liability ratio.
3. Maximise the expected return on the Scheme's assets and hence the likelihood of maintaining a position of actuarial solvency, subject to the constraints.
4. That there is not more than **1 chance in 10** that in 5 years time the Scheme will be in actuarial deficit; and
5. That there is not more than **1 chance in 50** that in 5 years time the Asset/Liability Ratio will be lower than **90%**.

Investment Objective

To achieve an annual average return of not less than **4%**, net of tax and expenses during the next **5** years. This is the discount rate used by the Actuary to value the liabilities of the Scheme.

Strategic Asset Allocation effective from 1 April 2008

Annual Single Premium	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	0	58	6.5	25	7.5	3	00

LEVEL PREMIUM SCHEME

Statement of 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.

Parameters

The investments objectives for the Level Premium Scheme are to:

1. Maintain the current minimum solvency ratio at 112%.
2. Maximise the expected return on the Scheme's assets, and hence the likelihood of improving the actuarial solvency, subject to the constraint that there is not more than **one chance in 10** that in 5 years time that the Asset/Liability Ratio will be lower than **80%**.

Investment Objective

To achieve an annual average return of not less than 4%, net of tax and expenses over the next 5 years. This is the discount rate used by the Actuary to value the liabilities of the Scheme.

Strategic Asset Allocation

Level Premium	Cash %	Fixed Interest %	New Zealand Equity %	Overseas Equity %	Property %	Commodities %	Fixed Interest No 2 (%)
	0	58	6.5	25	7.5	3	0

Definitions

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

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