Investment Policy

Derivative Management Policy Summary

Date of this Policy:
August 2017

1. Purpose and objectives

The purpose of this Derivative Management Policy (**the Policy**) is to support the Trustee's Investment Governance Framework and provide guiding principles for the use and oversight of derivatives within the Fund's investments.

The objective is to provide a framework for the governance of the use and control of derivatives and to ensure the Fund has effective operational, risk management and compliance controls when using derivatives.

2. Definitions

APRA means the Australian Prudential Regulation Authority.

ASIC means the Australian Securities and Investments Commission.

Asset means any item expected to provide future economic benefit.

Board means the trustee board of United Super Pty Ltd.

Derivative is a security whose price/return is dependent upon the price/return of some other underlying asset.

DRS – Derivative Risk Statement.

Fund is the Construction and Building Unions Superannuation Fund (Cbus).

IC is the Trustee's Investment Committee.

Prudential Standard means a standard determined by APRA under subsection 34C(1) of the Superannuation Industry (Supervision) Act 1993.

SIS Act means the Superannuation Industry (Supervision) Act 1993.

Trustee is United Super Pty Ltd.

3. Applications

This Policy applies to all Trustee Directors, all Cbus Group Executives, all members of the Fund's investment team, and all officers of the Fund.

4. Responsibilities and accountability

The Trustee is at all times responsible for formulating and implementing an investment strategy that is consistent with the circumstances of the Fund, including:

- deciding when and how to use derivatives;
- assessing the potential risks posed by derivatives and their corresponding mitigation strategies; and
- monitoring and reporting derivative exposures.

5. Definition of a derivative

A derivative is a financial instrument whose value depends on, or is derived from, the value of some other underlying asset, interest rate, currency rate or a variety of indices. Generally there are five main categories of derivatives identified by the assets from which they are derived:

- Equity derivatives;
- Currency derivatives;
- Interest rate derivatives;
- Credit derivatives; and
- Commodity derivatives.

6. Why use derivatives?

Derivatives are used to improve the Fund's risk return profile and increase the likelihood of the Fund's investment options meeting their investment objectives. Derivatives facilitate the management of investment risks and/or provide an efficient means of implementing various market exposures and investment strategies for the Fund.

7. Authorised use of deriviatives

The Fund's Trust Deed permits the use of derivatives.

Derivative use is not considered in isolation but rather as part of the overall investment strategy. Common uses of derivatives within the Fund are:

- For tactical reasons, i.e. to adjust the Fund's market exposure to an asset class by going long or short the appropriate derivatives;
- To hedge and control risk, including foreign currency risk;
- To facilitate transitions; and
- To implement investment strategies in a low cost and efficient manner.

8. Key Derivative Exposures

The key areas of the Fund's investment strategy that use derivatives are outlined below:

8.1 Derivatives in the Foreign Currency Overlay

The Fund uses derivative overlays to manage the Fund's exposure to foreign currencies.

8.2 Derivatives in the Asset Allocation Overlay

The Fund may use derivative overlays to manage its short term asset allocation decisions and rebalancing needs. Derivatives may be used to increase or decrease the exposure to asset classes and in most cases, the derivative positions are transitioned to physical exposures within three months.

8.3 Derivatives in Transition Management

Transitioning assets between managers requires careful management to ensure the risks and costs of the project are maintained within tolerable levels. Each transition is assessed on a case by case basis and where appropriate the Trustee will appoint a transition manager.

The instruments used in a transition will vary depending on which assets are being transitioned, but are generally short term positions whilst the physical movement of assets is arranged.

8.4 Equity Option overlay

The Fund may use equity put and call options to partially hedge its Australian and/or international equity exposure.

8.5 Derivatives with External Investment Managers

A number of the Fund's investment managers are permitted to use derivatives to help achieve their investment objectives.

8.6 Derivatives and Cbus Property

Cbus Property may use derivative instruments. The permitted use of derivatives includes:

- Put/Call Options to acquire or dispose of property or to participate in a development project; and
- Derivative contracts to hedge the interest rate risk of property debt financing.

The derivatives must not be speculative, uncovered or create gearing.

9. Restrictions on the use of derivatives

The Trustee permits the use of derivatives based on the following guiding principles:

- Their use is within the strategy, objectives and constraints permitted by the governing documents;
- Unless specified otherwise in the investment strategy, derivatives will not be used to obtain exposure that is substantially different from that which could be obtained through physical securities;
- There is adequate underlying asset cover to meet any obligations arising from the use of derivatives; and
- Proper consideration is given to liquidity management having regard to the particular portfolio strategy.

In addition, derivatives will not be used for speculation purposes to gear the portfolio or create net short positions. However, it is possible that some collective vehicles in which the Fund invests may allow derivatives to be used speculatively, for example a fund manager may use derivative contracts to acquire a position based on its future view of an asset, as opposed to a desire to hedge a current position.

10. Risk management

There are various risks associated with the use of derivatives. The fund has a number of controls in place to manage these risks.

Market Risk

Market risk represents the risk of adverse movements in markets for the derivative or the underlying asset, reference rate or index to which the derivative relates. Such a risk is created by holding a security, physical or derivative, which creates exposure to movements in prices of a security or market.

Liquidity Risk

There are two forms of liquidity risk.

1. The risk that the Fund may not be able to unwind or offset its positions at or near the previous market price, because of lack of market depth or disruptions in the market place; and
2. The risk that the Fund is unable to meet its cash flow obligations, such as margin calls on futures contracts.

Counterparty (Credit) Risk

Counterparty (also known as credit risk) is the risk the counterparty (being the other party to the derivative contract) will not honour (in whole or part) their contractual obligations. Exchange traded derivatives are traded via clearing houses, which significantly reduce the counterparty risk by requiring collateral or 'margin' deposits.

Further details in relation to the Fund's controls around counterparty risk are set out in the Fund's *Counterparty Risk Policy*.

Operational Risk

Operational risk is the risk of financial loss due to inadequate or failed internal processes, people, systems or external events.

Currency Risk

Some derivatives may have a foreign currency denomination and may lose value due to the adverse exchange rate movement.

Interest Rate Risk

Interest rate risk is the risk of loss due to price changes in interest rate sensitive instruments. There are a number of instruments that can be used by the Fund in managing interest rate exposure and they will be viewed in the context of the Fund's investment strategy.