MLC Derivatives Policy

1 Overview

The purpose of this policy is to provide guiding principles and policy directives for the use and oversight of derivatives used within the products, investment portfolios and shareholder funds (together known as “investment portfolios”) and the hedged asset portfolios (“hedged portfolios”) of the following MLC entities:

- MLC Investments Limited.
- MLC Limited.
- Navigator Australia Limited.

This policy replaces the Derivative Risk Statements of each of the above entities which were previously required under APRA’s Superannuation Circular II.D.7 entitled Derivatives (now withdrawn).

2 Scope

This policy applies to these entities in the following capacities:

Entity	Capacity
MLC Investments Limited	In its capacity as a Responsible Entity and Trustee of various pooled investment (collective investment) funds and in its own corporate capacity for the hedged portfolios.
MLC Limited	In its capacity as a life insurance company which offers investment-linked policies, earning rate based products and insurance policies.
Navigator Australia Limited	In its capacity as a Responsible Entity and Trustee of various pooled investment (collective investment) funds.

For the purpose of this policy, these entities are referred to collectively as NAB Wealth.

This policy governs the use of derivatives by:

- JANA Portfolio Management and JANA Advice and Research within the asset pools of NAB Wealth for which each act as investment advisors (“Advisors”) to NAB Wealth.
- Retirement Solutions as risk managers for the hedged portfolios managed on behalf of MLC Investments Limited operating in its own corporate capacity.
- NAB Wealth for any investments made by shareholders funds.

NAB Wealth manages investment portfolios in the following ways:

- Through a manager-of-managers approach where specialist investment management companies are appointed to manage assets (including derivatives) within each asset class. Each appointed investment manager must be subject to a rigorous selection process (which includes derivative capabilities) followed by ongoing monitoring and review.
- Through investments in external funds / vehicles (which may include the use of derivatives) which are governed by external fund documentation.

NAB Wealth manages its hedged portfolios through Retirement Solutions who acts as risk managers for the hedged portfolios managed on behalf on MLC Investments Limited operating in its own corporate capacity.

Investments made via MLC platforms and IDPS are out of scope for this policy. These investments are governed by the Investment Policy and Process document for MLC Nominees Pty Limited and NULIS Nominees (Australia) Limited.

3 Policy Statements

3.1 Guiding Principles specific to the use of Derivatives

For the purposes of this policy, a derivative means a financial contract whose value depends on, or is derived from, assets, liabilities or indices ('the underlying asset'). Derivatives include a wide range of instruments including but not limited to forwards, futures, options, swaps, warrants and other composites.

NAB Wealth will permit the use of derivatives within its investment portfolios and hedged portfolios only where their use is consistent with:

- The investment return objective and risk profile of an investment portfolio;
- Disclosures made to investors;
- Governing fund documentation;
- In respect of hedged portfolios, Retirement Solutions Hedging Strategies and Operations Manual;
- Any other legislative or regulatory requirements; and
- This Policy.

3.2 Purposes for which derivatives may be used

Derivatives are an important tool for prudent investment management and are integral to the investment risk management process. Their proper use should enhance the likelihood of meeting the overall investment performance objectives of an investment portfolio or the objectives of a hedged portfolio.

NAB Wealth may use derivatives in its investment portfolios for the following purposes:

Hedging:

- Hedging investment portfolio exposures (eg to protect the value of an asset in the portfolio and/or minimise the liability from a fluctuation in market values), including the creation of uncovered short positions where these are considered as an appropriate hedge for assets held in the portfolio.

Efficient Portfolio Management:

- Creating investment portfolio exposures to markets, currencies, securities and other financial or economic interests;
- Implementing changes in positions or in investment strategy including shifts in asset allocation between asset classes and/or adjustment to other asset exposures; and
- Reducing the transaction costs associated with the management of investment portfolios.

Investment Return Generation:

- Creating portfolio leverage (either long or short) in line with the investment objectives and risk profile of investment portfolios;
- Seeking to enhance investment portfolio returns including, but not limited to, by exploiting pricing anomalies between derivatives and the equivalent physical securities and efficiently executing directional views in markets, currencies and securities; and
- Creating uncovered short positions for the purpose of generating investment returns.

The use of derivatives to create leverage and/or hedge exposures within an investment portfolio must be consistent with the investment portfolio's approved objectives and risk profile, disclosure documents, applicable governing documents and legislative and / or regulatory requirements.

Investment portfolios incorporating leverage and/or uncovered positions will be considered on a strict case-by-case basis and will require approval from the Portfolio Construction Group within NAB Asset Management or the MLC Investment Approval Committee within NAB Wealth, as appropriate. Investments incorporating leverage made by shareholders funds will require approval from the applicable NAB Wealth Board.

NAB Wealth, including Retirement Solutions may use derivatives in its hedged portfolios for the following purposes:

Hedging:

- Hedging portfolio exposures to protect the value of an asset in the portfolio and/or minimise the liability from a fluctuation in market values.

The use of hedging within a hedged portfolio must be consistent with the Retirement Solutions Hedging Strategies and Operations Manual, disclosure documents, applicable governing documents and legislative and / or regulatory requirements.

3.3 Policy Statements

The following principles must be applied to the use of derivatives:

Responsibilities relating to Investment Strategy

Each NAB Wealth entity is fully responsible to investors for the prudent management and implementation of the investment strategy (including the use of derivatives) for each investment portfolio.

MLC's Advisors must:

- Provide recommendations to enable NAB Wealth to determine the overall investment strategy in relation to investment objectives and asset allocation for each investment portfolio; and
- Undertake the investigation, evaluation, monitoring, and appointment or termination of investment managers and for investments into external funds.

Appointed Investment Managers

NAB Wealth's Advisors must undertake an assessment to determine which specific types of derivatives should be allowed and appropriate limits on their use within investment portfolios. This assessment must include:

- the objectives of the investment portfolios;
- the overall risk profile of the investment portfolios;
- the markets in which the investment portfolios will be investing;
- the investment style(s) to be employed;
- the experience, qualifications and skills available within the investment managers appointed to use derivatives;
- the quality of internal controls/risk management procedures relevant to the use of derivatives; and
- the characteristics of the derivative market involved – liquidity, quality of counterparty, availability of valuations (including equitable valuation considerations), legal structure, and investment limits.

In the case of underlying investment managers governed by an Investment Management Agreement, these Agreements must include provisions relating to:

- Prudential standards of conduct;
- Investment objectives;
- Assets (including derivatives) which can be held; and
- In the case of derivatives:
    - The purpose for which derivatives may be used;

  - The types of derivatives which may be used; and
  - The limits of derivatives' use, individually (Gross Long / Short) and in aggregate (Net).

In the case of investment managers' use of derivatives, applicable controls are outlined and audited in each investment manager's internal controls report (ie SSAE16, GS007 or equivalent) which must be provided to NAB Wealth's Advisors on an annual basis.

In the case of underlying investment managers where the manager is accessed through an external fund, these funds are governed by their relevant fund documentation which typically includes provisions relating to:

- Prudential standards of conduct;
- Investment objectives;
- Target portfolio risk profile; and
- Range of allowable assets (including derivatives) which can be held.

Retirement Solutions

Retirement Solutions must undertake an assessment to determine which types of derivatives should be allowed and appropriate limits on their use within the hedged portfolios. This assessment must include:

- the objectives of the hedged portfolios;
- the overall risk profile of the hedged portfolios;
- the quality of internal controls / risk management procedures relevant to the use of derivatives;
- the characteristics of the derivative market involved – liquidity, quality of counterparty, availability of valuations (including equitable valuation considerations), legal structure, and investment limits.
- Prudential standards of conduct;
- Assets (including derivatives) which can be held; and
- In the case of derivatives:
  - The purpose for which derivatives may be used;
  - The types of derivatives which may be used; and
  - The limits of derivatives' use, individually (Gross Long / Short) and in aggregate (Net).

4 Investment Risk Management

Market Risk

Market risk represents the risk of adverse movements in markets (including asset prices, volatility, currency, or other market variables) for the derivatives or the underlying asset, reference rate or index to which the derivative relates. Market risk is created by holding any physical or derivative security which creates exposure to movements in prices of a market, currency, security or other financial or economic interest.

Market risk must be managed through ensuring investment portfolios are well diversified across investment managers, asset classes, regions, sectors and underlying securities, as appropriate.

In the case of investment managers governed by an Investment Management Agreement and the hedged portfolios managed by Retirement Solutions, where derivatives are permitted their use must be monitored to ensure it remains within pre-specified limits. This includes ensuring both the type and overall usage of derivatives on both a gross and net basis remain consistent with pre-specified ranges permitted for their use. These ranges vary by investment portfolio and hedged portfolio and must be determined in accordance with each investment portfolio's and hedged portfolio's overall risk profile and investment objective including target level of expected returns.

Controls

The following controls must be in place in the case of investment managers governed by an Investment Management Agreement and the hedged portfolios managed by Retirement Solutions:

- Compliance with the investment guidelines and hedging strategy (including derivatives) applicable to each investment portfolio and hedged portfolio must be monitored on a regular basis;
- The effective market exposure of all assets (including derivatives) in each investment portfolio and hedged portfolio must be monitored on a regular basis; and
- Stress testing of options holding investment portfolios and hedged portfolios must be conducted on a regular basis.

For investments into external funds, NAB Wealth's Advisors must undertake, to the extent reasonably practicable, periodic reviews to ensure the funds' use of derivatives is consistent with expectations and the applicable fund's investment objectives and profile.

Liquidity Risk

Liquidity risk has two components:

- Market Liquidity Risk: the risk that a particular position may not be able to be, or cannot be easily, unwound or offset at or near the previous market price because of inadequate market depth or because of disruptions in the market place.
- Cash Flow Risk: the risk that the future financial obligations of an investment portfolio will not be met as a result of its use of derivatives, for example margin calls on futures contracts.

Controls

The following controls must be in place in the case of investment managers governed by an Investment Management Agreement and the hedged portfolios managed by Retirement Solutions:

- Investment guidelines and hedging strategy must restrict:
    - The purpose for which derivatives may be used;
    - The types of derivatives which may be used; and
    - The limits of derivatives use, individually (Gross Long / Short) and in aggregate (Net).

- Investment portfolios and hedged portfolios must be required to maintain adequate liquidity to cover margin requirements from derivative use; and
- Specific liquidity requirements must be set on a portfolio by portfolio basis, recognising the expected level of derivative use and the nature of the underlying exposure and expected volatility of the derivative contracts being used.

For investments into external funds, NAB Wealth's Advisors must undertake, to the extent reasonably practicable, periodic reviews to ensure the funds' use of derivatives is consistent with expectations and the applicable fund's investment objectives and profile.

Counterparty Risk

Counterparty risk (also known as credit risk) is the risk that a counterparty, being the other party with whom a derivative contract is made, will fail to perform contractual obligations (i.e. default, either in whole or part).

Controls

The following controls must be in place in the case of investment managers governed by an Investment Management Agreement and the hedged portfolios managed by Retirement Solutions:

- All OTC derivatives must be executed with approved OTC Counterparties;
- All OTC derivatives must be executed under industry standards agreements such as ISDA's (or equivalent);
- All futures and exchange traded derivatives must be cleared through approved clearing entities;
- Futures must be traded on a relevant exchange and must be fully collateralised daily in accordance with exchange requirements;
- Where counterparty exposure limits are stipulated by investment guidelines or hedging strategies, these must be monitored; and
- The use of authorised OTC Counterparties must be monitored.

For investments into external funds, NAB Wealth's Advisors must undertake, to the extent reasonably practicable, periodic reviews to ensure the funds' use of derivatives is consistent with expectations and the applicable fund's investment objectives and profile.

Operational Risk

Operational risk is the risk that deficiencies in the effectiveness and accuracy of information systems or internal controls will result in a material loss. Such material loss may be caused by human error, system failures, inadequate procedures, or a lack of internal management controls.

As part of the investment manager selection and ongoing monitoring process, NAB Wealth's Advisors must assess each investment manager's operational risk, including in respect of derivative use. Where investments are made through external funds, the Advisor must also assess the operational risk of these investments.

In the case of investment managers governed by an Investment Management Agreement and the hedged portfolios managed by Retirement Solutions all transactions must be settled by NAB Wealth's appointed Custodian. The value of all assets, including derivatives is where practicable marked to market daily by the Custodian using independent valuation sources. Where the Custodian is unable to readily value particular assets, including derivatives, advice may be sought from NAB Wealth through its Advisors or Retirement Solutions.

Personnel Management

NAB Wealth's Advisors and Retirement Solutions must ensure that all staff responsible for reviewing investment managers, managing investment portfolios and hedging portfolios and marketing investment management services are appropriately qualified and experienced. Staff must be supervised as appropriate to their areas of responsibility and their performance must be reviewed periodically.

All senior management and employees involved in monitoring derivative exposures must have appropriate training and must have an understanding of derivatives and all aspects of this Policy.

All representatives must be encouraged to undertake additional training in the interests of maintaining a satisfactory level of professional expertise in regards to derivatives usage.

Assessment of Controls

The internal auditor periodically assesses the Advisors' and Retirement Solutions internal control environments and procedures must be in place to monitor the results of these audits, and must ensure that recommendations are implemented on a timely basis.

Reporting

NAB Wealth's Advisors and Retirement Solutions must provide such reports as are considered necessary by NAB Wealth to enable NAB Wealth to fulfil its responsibilities under this Policy and its AFSL. Such reporting must include investment and policy breaches, derivative exposures, OTC counterparty exposures and the results of portfolio stress tests. Reporting with respect to compliance matters must have due consideration to materiality, with escalation of any material incident to NAB Wealth.

5 Policy review

Any change to the derivatives policy requires the approval of the applicable Wealth Boards. This policy is to be reviewed on an annual cycle or earlier when required.

6 Contact Details

The Policy Owner Jonathan Armitage – Chief Investment Officer JANA Portfolio Management.

7 Related Policies & References

7.1 Corporations Act and Life Insurance Act Obligations

- Corporations Act.

7.2 Related Policies

- Asset Valuation Policy.

7.3 Key regulatory principles and industry standards

The key regulatory principles and industry standards governing asset valuations include:

- APRA Prudential Practice Guide SPG 200 - Risk Management.
- APRA Prudential Standard LPS 220 – Risk Management.
- APRA Prudential Practice Guide LPG 200 – Risk Management.
- ASIC Regulatory Guide 94 – Unit Pricing.