

Externally Managed Investments Policy

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Document History:

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Note this version supersedes all earlier draft versions (#131005)				
1e	21 Feb 2012	Update to Schedule 6 to account for completion of conviction assessments out of policy.	CEO	Final
1f	11 Sept 2012	Update reference to Master Checklist to Investments Implementation File and include ORA in Schedule 5 and change GM AA to GMPC	CEO	Final
2	31 Oct 2012	Consolidate due diligence and monitoring policies and update Competency and Monitoring frameworks	Board	Final
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3A	2 July 2015	Changes to ensure consistency with Derivatives Policy, and minor tidy-ups	CEO	Final
4	15 Sep 2015	Update Section 7 making clear staff obligations in relation to bribery and corruption risks relating to investments and appointment of investment partners.	Board	Final
5	16 Dec 2015	Consequential changes light of the changes under the New Zealand Superannuation Retirement and Income Amendment Act 2015.	Board	Final
5A	8 Dec 2016	Update to Schedule 7 (Legislative Compliance) and update to reporting requirements	CEO	Final
5B	24 Feb 2017	Update to Schedule 1 (Responsibilities)	CEO	Final
6	6 April 2017	Amendments to Schedule 4 and other minor consequential amendments in relation to the securities lending programme	Board / CEO	Final
6A	28 Nov 2017	Update to Schedule 3 (Conviction and Monitoring Framework)	CEO	Final

Version	Date	Changes/Modifications	Approved By	Status
7	28 June 2018	Updates to reflect the current Nigel Chair responsibilities and processes. Amendments to the descriptions around manager monitoring frequency. Updates to statutory references for changes in legislation. Updates to investment team names that no longer exist.	CEO	Final
8	3 Mar 2020	Updates to reflect the Venture Capital Fund Act 2019 and from regular policy review	Board / CEO	Final
8A	13 Mar 2020	Update to Schedule 1 (Responsibilities)	CEO	Final

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1. Background

- 1.1. We are responsible for investing two funds – the New Zealand Superannuation Fund (**Fund**) and the Venture Capital Fund (**VCF**).

New Zealand Superannuation Fund

- 1.2. For the Fund, we have established a **Reference Portfolio**, and seek to add value to the Reference Portfolio through Strategic Tilting, Active Returns, and Portfolio Completion.
- 1.3. We appoint external **investment managers**, or invest in **collective investment vehicles** offered by external investment managers, to help us access our desired investment exposures for the Fund. Such appointments or investments might be made to achieve the market **exposures** expressed in the Reference Portfolio, or as a way of adding value via Active Return investments, or as some combination of the two.

Venture Capital Fund

- 1.4. For the VCF, we act as the limited partner of a Limited Partnership managed by the New Zealand Venture Investment Fund Limited (**NZVIF**), which seeks to invest on a “fund of funds” basis in accordance with broad parameters set out in the **Policy Statement** issued by the Minister of Finance.
- 1.5. The appointment of NZVIF as initial manager of the VCF was required pursuant to the Venture Capital Fund Act 2019 (**VCF Act**).

2. Objective

- 2.1. To implement effective controls and frameworks to ensure that all aspects of our relationships with external investment managers are managed effectively and in compliance with our governance and legislative requirements.

3. Definitions

- 3.1. To aid with interpretation of this policy we have a Glossary of Terms. The first instance of any defined term is highlighted in bold. References to other documents are italicised.
- 3.2. Except where otherwise necessary, we use the term investment manager (or **manager**) to describe both investment managers we appoint and those who manage collective investment vehicles in which we invest.
- 3.3. Similarly, we use the term **investment** to describe what might also be called a **mandate**. It does not refer to a component part of an investment mandate with an investment manager.

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4. Scope

- 4.1. This policy covers how we assess, engage with, and monitor external investment managers. It also covers how we compensate them for their services and (if applicable) how we terminate the relationship once those services are no longer required.
- 4.2. This policy does not cover:
 - Maximum allocation of capital to a manager for the Fund, which is governed by the *Investment Risk Allocation Policy*.
 - **Direct investment** in assets (not being collective investment vehicles or segregated accounts covered by this policy) which is governed by the *Direct Investment Policy* or **financial markets transactions** (covered by the *Portfolio Completion and Internally Managed Securities Policy*); or
 - Appointments of **Portfolio Completion Agents**, which are governed by the *Portfolio Completion and Internally Managed Securities Policy*.
- 4.3. There may be situations where an investment is a hybrid between direct investment (as defined above) and an externally managed investment. Where this is the case, the Direct Investment Policy will normally apply along with Section 7 (Investment Manager Search, Selection and Monitoring) of this policy. The CIO will decide the level to which each policy applies (including whether any new investment is considered an investment managed under this policy or the Direct Investments Policy).

5. Delegations and Authorities

- 5.1. The *Delegations Policy* governs the delegations and authorities that apply in all policy documents. In the event of any discrepancy between this policy and the *Delegations Policy* the *Delegations Policy* will prevail.
- 5.2. The Board has reserved certain matters either to itself, a committee of the Board or the Chief Executive. Those matters are outlined in the Delegations Policy. All other matters are delegated to the Chief Executive who may sub-delegate them to Guardians' staff. All delegates and sub-delegates must exercise their authorities in compliance with the general conditions of delegation and sub-delegation set out in Schedule 2 of the *Delegations Policy*.
- 5.3. There are certain responsibilities inherent under this policy. Those responsibilities, and the person responsible for them, are outlined in Schedule 1.

6. Active Investment Decision Framework

- 6.1. For the Fund, whether an appointment of a manager is made will depend on:
 - An investment manager being the preferred access point type for a specific investment opportunity; and
 - A positive outcome from the investment manager search and selection process (as described in Section 7 below)
- 6.2. For the VCF, the appointment of NZVIF was required by the VCF Act. Any future appointment of a manager would be influenced by the VCF Act, the investment approach for the VCF required under the Policy Statement, and a positive outcome of the search and selection process (as described in Section 7 below).

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- 6.3. For **passive** investments by the Fund (where a manager is replicating a market exposure specified in the Rebalancing Portfolio with no attempt to add further value) we will evaluate the cost of that investment compared to other ways of achieving the same exposure.
- 6.4. For **Active Return** investments by the Fund we will maintain and adhere to an active investment decision framework that focuses on the following:
- Identifying the reasons why we see an **investment opportunity**;
 - Identifying the best access point including evaluating the cost of that access point compared to alternative access points;
 - Calculating the expected risk and return characteristics of the investment after fees and **non-recoverable foreign taxes**; and
 - Calculating, together with sensitivity analyses, the incremental impact on the Fund from making the investment.
- 6.5. An outline of that framework for the Fund must be maintained in Part A of Schedule 2.
- 6.6. For VCF, the new manager appointment framework is set out in Part B Schedule 2.

7. Conviction and Monitoring

- 7.1. We will maintain and adhere to an investment manager search, selection and monitoring framework that focuses on using our own and others' judgement, and systematic and other objective sources and tools, to assess any potential manager in terms of their:
- Competence to execute on the specific opportunity we employ them to access and performance once appointed;
 - Broader suitability as a partner for the Guardians, including general conduct; their attitude and experience with responsible investment, and willingness and ability to share knowledge that supports our investment processes and tools;
 - Compliance with the terms of any management agreement or securities lending authorisation agreement with them, and adherence with offering documents and any side letter agreements;
 - Alignment with the Fund (and in the case of a manager for the Fund); and
 - Suitability in the context of the VCF's purpose and the requirements of the Policy Statement (in the case of a Manager for the VCF).
- 7.2. We will regularly update our institutional view of each manager we have appointed to ensure compliance with the terms of their appointment. An outline of that framework must be maintained in Schedule 3.
- 7.3. The Guardians' reputation and standing could be damaged by the acts of people working within our investments and investment partners (together referred to as third parties). As such we are committed to promoting compliance with effective anti-fraud, anti-bribery and corruption policies by all third parties with whom the Guardians is engaged. This includes advising third parties of our processes for reporting any potential concerns. Appropriate due diligence will be undertaken before any acquisition of an investment or third parties (e.g. external legal advisors) are engaged. The approach should take into account the risk and the size of the organisation. All arrangements with third parties should be subject to clear written terms. Where appropriate this should include specific

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provisions requiring them to comply with minimum standards and procedures in relation to preventing fraud, bribery and corruption. Staff must not engage any third party that is known to engage or reasonably suspected of engaging in bribery, corruption or fraudulent activity.

- 7.4 An outline of the search, selection and monitoring framework must be maintained in Schedule 3.

8. Investment Manager Fees

- 8.1. For the Fund, we will maintain and adhere to an investment manager fee evaluation framework that ensures the terms for every investment are appropriate for the investment being considered on an on-going basis. An outline of that framework must be maintained in Schedule 4.
- 8.2. For the VCF, we will provide for fees in the first instance on a cost-recovery basis in the limited partnership arrangements with NZVIF.

9. New Investment Implementation

- 9.1 We will maintain and adhere to a new investment implementation process that ensures that legal, operational, responsible investment, reputational, finance or, tax, issues relating to either the manager or the investment have been identified and managed appropriately.
- 9.2 An outline of that framework must be maintained in Schedule 5.

10. Approvals

- 10.1 The authority for appointing investment managers, amending the terms, terminating and divesting are set out in the Delegations Policy.

11. Monitoring

- 11.1. In managing and administering the VCF we are required to “give effect” or “have regard” (as applicable) to directions contained in the Policy Statement issued under the VCF Act.
- 11.2. The sole initial investment of the VCF is the limited partnership interest in the “fund of funds” which is managed by NZVIF. As such, the principal ways in which we “give effect” or “have regard” (as applicable) to directions in the Policy Statement are:
- by including appropriate requirements in the terms of appointment of NZVIF; and
 - through our monitoring and conviction oversight of NZVIF.

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- 11.3. From time to time, the Minister of Finance may amend the Policy Statement. The Minister of Finance is required to consult with (and in certain cases require the agreement of) the Guardians before amending the Policy Statement.
- 11.4. Any changes to the Policy Statement do not impact any existing investments or commitments of the VCF. However, we will request that NZVIF complies with updated Policy Statements where reasonably practicable to do so.
- 11.5. Board approval is required for the Guardians to agree to any material change to the Policy Statement under the *Delegations Policy*.

12. Reporting

- 12.1 We must report periodically to the Board on the following matters, primarily through the annual review process or on an ad hoc basis for significant matters:
- Any first time commitment to a collective investment vehicle;
 - Investment manager performance;
 - Material instances of manager non-compliance with the terms of an investment management agreement, securities lending authorisation agreement or relevant documents for a collective investment vehicle;
 - Investment manager terminations; and
 - Disposal of an entire interest in a collective investment vehicle.
- 12.2 We must report to the Board for their approval on any termination of NZVIF's appointment in respect of the VCF.
- 12.3 We must report proposed material changes to the following schedules to the Board for their approval:
- Schedule 6: Reporting Framework
- 12.3 We must report to the Board, for their information, material changes to the following schedules to this policy:
- Schedule 1: Responsibilities
 - Schedule 2: Active Investment Decision Framework
 - Schedule 3: Conviction and Monitoring Framework
 - Schedule 4: Investment Manager Fees
 - Schedule 5: New Investment Implementation Framework
 - Schedule 7: Legislative Compliance
- 12.4 An outline of the current reporting framework, for reporting to the Board, including any reporting to internal management committees, must be maintained in Schedule 6.

13. Legislative Compliance

- 13.1 We have a legislative compliance framework to ensure that we comply with our legislative obligations. In each of our policies, we list specific legislation that might impact on the activities covered by that policy. The list is not always exhaustive as often the law is specific to a particular aspect of the activity or jurisdiction in which the activity occurs.
- 13.2 We will ensure that all our activities under this policy comply with our legislative obligations and give effect to our legislative compliance framework.
- 13.3 A list of legislation that potentially impacts on the activities under this policy, together with a brief description of how the legislation relates to the activity, must be maintained in Schedule 7.

14. Control Section

Approved this 6 day of **April 2017, and amended 21 January 2020**

Chief Investment Officer _____

Chief Executive Officer _____

Board Chairman _____

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Schedule 1: Responsibilities

CIO will:	<ul style="list-style-type: none"> • ensure this policy is kept current and relevant to the activities being undertaken (including schedules 1-7) • ensure this policy is reviewed every five years • report first time commitments to CIVs, manager appointments to subsequent Investment Committee and Board meetings • report material changes to the VCF Policy Statement (including proposed changes requiring Board approval) to subsequent Investment Committee and Board meetings • report disposal of entire interests in CIVs, manager terminations to subsequent Investment Committee and Board meetings • report material changes to IMAs and agreements governing CIVs to subsequent Investment Committee and Board meetings • report appointment to represent GNZS on committee, board or similar body of CIV six monthly and under the no surprises protocol to subsequent Risk Committee and Board meetings • decide deviation from the full due diligence process • where suitable, sign-off to new investments in-line with the New Investment Implementation Framework • decide whether any new investment is considered an investment managed under this policy or the Direct Investments Policy
General Manager of Portfolio Completion will:	<ul style="list-style-type: none"> • report material changes to securities lending authorisation agreements to subsequent Investment Committee and Board meetings
Chair of the Investment Committee will:	<ul style="list-style-type: none"> • consider all proposals to appoint or terminate a manager or invest in or dispose of interest in a CIV for the Fund where they are required to be endorsed by the IC • consider all proposals to appoint or terminate a manager or invest in or dispose of interest in a CIV for the VCF • oversee monitoring of manager conviction reviews and other such reviews of manager access points as determined by the Investment Committee to be appropriate
Chair of the RC will:	<ul style="list-style-type: none"> • provide oversight of the Operational Risk Assessment (ORA) process.
Chair of the New Investments Group will:	<ul style="list-style-type: none"> • in conjunction with the New Investments Group, carry out the overall assessment of the risks in an ORA and which risks need to be escalated to the Investment Committee/authorising person • inform the RC of the risks it has identified for the Investment Committee/authorising person to consider • where necessary/desirable, seek input from the RC to form a view on assessing a particular risk • ensure schedule 5 (New Investments Implementation Framework) is kept current
Lead Investment Professionals will:	<ul style="list-style-type: none"> • be responsible for the execution and ongoing management and monitoring of an investment • undertake post implementation review of complex new opportunities and investments • maintain overall relationship with managers • meet with managers (preferably in their offices), and update conviction review of managers, both at least annually, or as otherwise agreed with the CIO or Head of External Investments and Partnerships • be responsible for annual reconciliation of manager fees

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Head Risk will:	<ul style="list-style-type: none"> • report material manager non-compliance to subsequent Risk Committee and Audit Committee meetings • ensure that operational review of each manager is conducted at least biannually • report material policy breaches notified through the Learning Opportunities reporting process immediately to the Risk Committee and Board • report all policy breaches notified through the Learning Opportunities reporting process to the subsequent Audit Committee meeting
All Investment & Portfolio Risk & Compliance staff will:	<ul style="list-style-type: none"> • report any identified adverse issues at a manager immediately to the Head of External Investments and Partnerships and the CIO
Head of External Investments & Partnerships will:	<ul style="list-style-type: none"> • ensure schedule 2 (Active Investment Decision Framework) is kept current • ensure the Compliance and Operational monitoring sections of schedule 3 (Conviction and Monitoring Framework) is kept current • ensure schedule 4 (fees) is kept current • report non-material changes to CIVs and IMAs to CIO • report manager conviction assessments at least once a year to either 1) CIO and GM Finance and Risk or 2) the Investment Committee • report any identified adverse issues at a manager immediately to the Head of Communications • approve conviction reviews
General Counsel will:	<ul style="list-style-type: none"> • ensure schedule 7 (legislative compliance) is kept current • report material changes to the schedules of this policy as part of the annual SIPSP review to the Risk Committee and Board meetings and under the no surprises protocol.

Responsibilities approved by Chief Executive 5 December 2014, and updated 24 February 2017, 6 April 2017, 28 June 2018, 3 March 2020, and 13 March 2020

Schedule 2: Active Investment Decision Framework

Part A (Fund)

Our investment process is available online. This schedule summarises the key parts of that process. For all investments, we analyse how much the investment would improve the Fund's portfolio. That analysis aims to reveal:

- The best access point;
- The **expected return** of the investment;
- The expected risks of the investment;
- The expected costs associated with the investment;
- Its fit with the rest of the portfolio; and
- The appropriate amount to allocate to the investment.

We compare all investments on a consistent and like-for-like basis.

We compare the expected net return from the investment with its hurdle required return, which is the minimum or break-even return needed to ensure that the portfolio would be improved by making the investment. The hurdle consists of the expected return of the proxy, i.e. the funding source (some combination of growth and income assets in the Reference Portfolio) that matches the risk characteristics of the investment, and compensation for illiquidity and idiosyncratic risks as required.

The expected return analysis should consider the long-term expected return, and should highlight key assumptions and other potential outcomes. Our commercial judgement about expected future returns should be based on a wide range of quantitative and qualitative evidence, including internal and external research wherever possible. We try to ensure that the assumptions behind the expected return analysis are consistent with the other assumptions in our investment case framework, for instance our own views on the expected return we can expect from the Reference Portfolio.

Risk analysis should include an analysis of the likely profile of the future investment returns and how the investment is likely to behave under differing conditions. It is important to test how sensitive the investment case is to different assumptions about the business or market environment. Consideration should also be given to non-investment risks (these are covered in greater detail as part of the new investment implementation framework at Schedule 5).

Costs should be analysed under different scenarios and should incorporate all non-recoverable costs including fees and foreign taxation. When we estimate expected performance fees, where practical, we attempt to estimate the probability weighted average fee under a wide range of alternative scenarios to take into account the general asymmetry of performance fees (i.e. managers do not pay us when they underperform).

The appropriate desired risk allocation to the opportunity is the responsibility of the relevant Risk Budget team. The allocation to a specific investment within an opportunity is the responsibility of the Access Point teams and will depend on a range of factors including:

- (a) Our view on the relative attractiveness of the investment versus other investment opportunities in the relevant risk basket;
- (b) The expected risk adjusted return;
- (c) Our degree of confidence around the investment case;
- (d) Its similarity to other investments in the portfolio;
- (e) The minimum size required to achieve the appropriate level of diversification; and

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- (f) Our prudential limits, including single asset and single manager limits.

CIV investments, IMA investments and appointments of Securities Lending Investment Managers

A written recommendation to appoint a manager is presented to the Investment Committee, or the authorising person (as applicable).

The presentation to the Investment Committee or authorising person will include a comprehensive summary of all due diligence to date. This will highlight the analysis carried out and will include the key commercial terms on which a manager will be engaged. The presentation will also highlight any due diligence or contractual issues that remain unresolved.

The New Investments Group (NIGEL) will analyse the risks set out in the Operational Risk Assessment and determine which risks need to be escalated to the Investment Committee or authorising person. The NIGEL via its Chair will inform the Risk Committee of the risks it has identified for the Investment Committee/authorising person to consider, and may also seek input from the Risk Committee to form a view on assessing a particular risk.

We may make use of external advisors or consultants to assist in all or part of the above process.

Occasions when the full process cannot be followed

From time to time opportunities will arise under circumstances which preclude the full process from being followed. In these cases, it will be acceptable to proceed if the degree to which the process has been deviated from is clearly identified and the risks arising from that deviation are identified. It is the responsibility of the Chief Investment Officer to determine the appropriate level of due diligence and must receive agreement from the NIGEL via its Chair if an ORA is not to be undertaken. In any event, the Investment Committee can request more information before endorsing or rejecting a recommendation.

Part B (VCF)

A written recommendation to appoint a manager is presented to the Investment Committee (as required).

The presentation to the Investment Committee will include a comprehensive summary of all due diligence to date. This will highlight the analysis carried out and will include the key commercial terms on which a manager will be engaged. The presentation will also highlight any due diligence or contractual issues that remain unresolved.

The NIGEL will analyse the risks set out in the Operational Risk Assessment and determine which risks need to be escalated to the Investment Committee. The NIGEL via its Chair will inform the Risk Committee of the risks it has identified for the Investment Committee to consider and may also seek input from the Risk Committee to form a view on assessing a particular risk.

We may make use of external advisors or consultants to assist in all or part of the above process.

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From time to time opportunities will arise under circumstances which preclude the full process from being followed. In these cases, it will be acceptable to proceed if the degree to which the process has been deviated from is clearly identified and the risks arising from that deviation are identified. It is the responsibility of the CIO to determine the appropriate level of due diligence and must receive agreement from the NIGEL via its Chair if an ORA is not to be undertaken. In any event, the Investment Committee can request more information before endorsing or rejecting a recommendation.

Approved by Chief Executive on 17 June 2015, and updated on 6 April 2017, 28 June 2018, and 3 March 2020.

Schedule 3: Conviction and Monitoring Framework

We evaluate managers (initially and then on an ongoing basis) in three ways:

1. 'Conviction' – our confidence in the manager's competence to execute on an investment opportunity and in the general quality and 'fit' of the institution, including but not limited to its policies and procedures for Responsible Investment;
2. Operational Due Diligence (Ops DD) – the manager's regulatory, operational, organisational and financial processes and procedures; and
3. Compliance Monitoring of the managers' adherence to the investment arrangements e.g. IMA, for each investment.

Each evaluation is done by separate teams with different reporting lines.

- Ops DD has their own gate but is not a gate to investment. If a manager does not pass this review, the Ops DD recommendation is noted via the ORA process and in the Ops DD report. If the investment proceeds, Ops DD will work with the manager to attempt to resolve the areas of concern. Once invested, if we have operational concerns, we act on them immediately (including termination if appropriate)
- Ops DD ratings are included within Conviction as they significantly inform our confidence in a manager's Process Capabilities and Viability (both are Conviction factors)
- The Portfolio Risk team acts, typically with the Custodian and the relevant access point teams, to resolve compliance breaches with the manager. Where breaches are material they may have Conviction implications.

Why have Conviction?

1. It provides a framework for monitoring a manager's competence to execute on one or more specific opportunities
2. It is a discipline forcing us to evaluate our managers at least annually (or immediately if there is a serious issue)
3. It provides part of an internal record of our reasons for deciding which third parties should, and should not, manage NZ taxpayers' funds and for regularly re-assessing whether they remain fit and competent to do so

When do we have Conviction?

Whenever we have an investment that is governed by this policy, a conviction review needs to be written. A conviction score needs to be in place before we make such an investment with a manager and it needs to be maintained **as long as we** have such an investment with that manager.

How does Conviction work?

'Conviction'-based monitoring maintains, or raises questions about, our confidence in a manager's competence to execute on the specific opportunity we have appointed them to access. Key inputs to this are the manager's performance (over periods relevant to the opportunity they are accessing), their overall conduct and the extent to which they are meeting any knowledge transfer expectations that we have of them.

The Lead Investment Professional maintains regular contact with each manager to monitor that manager's on-going management and maintain our conviction assessment. At a minimum the Lead Investment Professional (or their delegate) meets with each of their assigned managers each calendar year (preferably in the manager's office). The Lead

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Investment Professional updates their written conviction assessment of the manager at least annually. Conviction reviews are reviewed for consistency and approved by the Head of External Investments & Partnerships, or Head of Direct Investments (as appropriate) or, in relation to Securities Lending Investment Managers, by the Head of Portfolio Completion.

Factors and Assessment

In forming conviction for an active manager we consider eight factors, shown in the table below. For passive managers, we exclude ‘People Capabilities’ and ‘Opportunity Consistency’ as those factors are less applicable.

	Factor	Assessment
Hygiene Factors	Viability	Is the manager stable and secure?
	Trust	Can we believe what the manager says?
	Structure and Focus	Are the fees and terms in line with our interests?
Competence Factors	Risk Awareness & Management	Can the manger identify, assess and manage risk?
	People Capabilities	Do they have the right team for the mandate?
	Process Capabilities	Do they correctly source & execute investments?
Outcome Factors	Opportunity Consistency	Does they clearly understand the opportunity?
	Performance	Do returns meet our thresholds?

Scoring

Each factor is considered separately and scored on a four point scale:

1. Red (very low)
2. Orange (low)
3. Green (acceptable)
4. Green Plus (leading)

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The scores for each factor determines the overall conviction score, according to the range shown in the table below.

Flags	Score	Impact	Action
Green / green+ flags	80-100%	Excellent	Normal monitoring
All green flags	70-79%	Good	Normal monitoring
One or two orange flags	60-69%	Threshold	Higher than normal monitoring, depending on reason for orange flag High touch if issue if it is something that can be resolved through intervention, Regular if more structural (e.g. if due to non-Target Operating Model compliant structure)
Three (or more) orange flags; or One (or more) red flags	59% or Below	Sub threshold	Terminate or recommend to Investment Committee why we should retain

The Monitoring Framework

Performance monitoring

The **Investment Committee (IC)** will monitor the investment performance as part of the annual Access Point performance review, and where appropriate the investment risk, of each manager relative to our expectations for the investment or mandate they manage on our behalf.

Performance is monitored by the Lead Investment Professional on a monthly or quarterly basis, although more emphasis is given to longer-term measures. The appropriate timeframe over which to measure the performance of a particular manager will be conditional on the investment being managed.

For every manager we appoint via an investment management agreement, or securities lending agency agreement, the agreement will contain specific reporting requirements. For each collective investment vehicle we invest in the governing agreement will contain specific reporting requirements. Where appropriate, and where possible, we will negotiate additional reporting requirements in a side-letter.

Adverse event reporting

We aim to ensure that managers self-report if there has been a material adverse change to their circumstances. Where we have an investment management agreement in place this reporting is mandatory. Where we are investing in a collective investment vehicle, it may be conditional upon us negotiating it in a side letter (if that is an option) to the collective investment vehicle. Self-reporting requirements include:

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- Quality of investment personnel;
- Departure of any key investment personnel;
- Integrity of investment process;
- Operational competency;
- Risk management process of the investment manager;
- Any investigation by any governmental or regulatory agency or any self-regulating organisation;
- A qualified audit opinion; and
- Acts or omissions likely to cause loss.

If we identify any issue that may have a reputational impact on the Fund or VCF or the Guardians we immediately report it to the Head of Communications. If there is a potential breach of law we immediately report it to the General Counsel.

Compliance monitoring

Our custodian monitors those managers appointed under an investment management agreement for compliance with the prescribed investment guidelines. The custodian reports on active and passive breaches of those guidelines to us and the manager. The custodian also provides us regular reports that enable us to:

- monitor the effective exposures and cash position with each manager; and
- reconcile mandate values and cash flows with each manager.

We monitor all managers to ensure that they do not hold any investment that we have expressly directed them not to hold.

We report summaries of active and passive breaches to the **Audit Committee** at each of their meetings.

Operational Monitoring

To ensure a manager's continuing operational capability, we aim to meet with them on a frequency determined by the Operational Due Diligence team's view of operational risk, investment strategy, and manager capability.

This review includes updating our written assessment of the manager, or our Operational Due Diligence team may request managers to complete biannual operational due diligence questionnaires.

In addition, as part of the monitoring process, we typically require managers to make available the following documents either on a monthly, quarterly or annual basis as set out in the Investment Management Agreements (IMAs), constitutional documentation for collective investment vehicles, or other applicable documents:

- Risk Management Certificate;
- External audit report (if completed);
- Industry standard (e.g. **SAS 70 Type II**) internal controls review (if available);
- Any licence they are required to hold (upon its renewal or amendment);
- Amended policies documents and compliance manuals (if they have made substantive changes to those policies); and
- Insurance certificates.

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In the case of collective investment vehicles, we are sometimes not able to access all of these documents.

Where a manager's mandate allows the use of derivatives, undertake an assessment to determine which specific types of derivatives should be allowed (based on a risk assessment and the investment guideline) and the appropriate limits on their use.

Where a manager's mandate, or a commingled vehicle, allows the use of derivatives we will (at appointment and on an ongoing basis) review to ensure there is effective management and oversight of derivative usage:

- Applicable derivative documentation and investment guidelines;
- Operational procedures for control and monitoring derivative activity; and
- Staffing resources and capability.

Receipt, Recording and Distribution of Manager reporting

Reports required from managers by their governing investment management agreement or collective investment vehicle documentation are directed to a single email address – compliance@nzsuperfund.co.nz. This allows incoming reports to be logged, correctly stored and readily available for review by the Lead Investment Professional and Portfolio Risk and Compliance unit.

It is the responsibility of the Portfolio Risk and Compliance unit to monitor for the receipt of notice of adverse events and, as soon as practically, bring it to the attention of the Lead Investment Professionals.

IC Oversight

The IC will review investment activity by access point team (i.e. External Investments and Partnerships, Portfolio Completion and Direct Investments) annually. The IC will also separately review the investment activity for the VCF as reported by External Investments and Partnerships annually. Reviews will include a discussion of the access points managed by the respective teams and their performance. As part of those reviews, the IC enquires into the broader aspects of manager performance such as operational compliance and management of responsible investment issues. In addition, the IC receives an annual update from External Investments and Partnerships and Operational Due Diligence in respect of our conviction and monitoring activities.

Occasions when the full process cannot be followed

From time to time opportunities will arise under circumstances which preclude the full process from being followed. In these cases it will be acceptable to proceed provided that the degree to which the process has been deviated from is clearly identified and the risks arising from that deviation are identified. It is the responsibility of the Chief Investment Officer to determine the appropriate level of due diligence. In any event, the Investment Committee can request more information before endorsing or rejecting a recommendation.

Approved by Chief Executive on 5 December 2014, 2 July 2015, 6 April 2017, 28 November 2017, 28 June 2018, and 3 March 2020

Schedule 4: Investment Manager Fees for the Fund

We consider a number of elements, including:

- The standard terms of the specific investment opportunity;
- The standard terms of similar opportunities in the same universe;
- The expected level of risk of the strategy;
- The expected return of the investment;
- The size of our expected investment;
- The appropriate hurdle/benchmark for the opportunity;
- The expected duration of our investment;
- The marked to market valuation on an investment versus its cash-flows; and
- The optionality of an incentive fee (if one is included);

For passive manager appointments we prefer not to pay an incentive fee.

For securities lending investment manager appointments we require a competitive fee revenue split that takes into account factors such as:

- Whether the securities lending programme is or is not indemnified;
- The operational cost on collateral risk management;
- The operational cost on managing corporate actions, recalls and manufactured dividends; and
- The level of origination of lending by the securities investment manager.

For value adding investments in listed markets we prefer:

- Incentive fee arrangements where an appropriate hurdle/benchmark is in place;
- To pay a fees as a percentage of performance in excess of a benchmark rather than a percentage of total return after performance exceeds a benchmark;
- That **incentive fee** arrangements have a high-water mark. That is once an investment begins to underperform, that underperformance must be made up before any positive performance fees are paid out;
- To retain at least 50% of any active value add, after paying fees to the manager
- Lower base fees and higher incentive rates for the same investment, conditional on a suitable hurdle/benchmark, all else being equal; and
- As long a period as possible to measure performance fees.

For value-adding strategies in unlisted markets we generally have the same set of preferences as with public markets with the following provisos:

- We prefer to have incentive fees paid by reference to the performance of the entire mandate, as opposed to on a deal by deal basis;
- We prefer base and incentive fees paid by reference to the equity committed or invested within an investment, not the gross asset value; and
- If incentive fees are to be paid on valuation rather than realisation we prefer long deferral periods before payment to accommodate volatility in asset valuations.

The Lead Investment Professional is responsible for completing an annual reconciliation of manager fees.

Approved by Chief Executive on 5 December 2014 and updated 6 April 2017 and 3 March 2020.

Schedule 5: New Investment Implementation Framework

Consistent with Schedule 2, new investments cannot proceed without authority from the CIO, General Manager Portfolio Completion, or the Head of EIP and will be in accordance with the following key principles:

1. We have clear new initiative ownership:
 - The Lead Investment Professional is responsible for the execution and ongoing management of an investment.
2. We seek and welcome multiple points of analysis:
 - Each business unit of the Guardians that may be affected by a new investment will scrutinise and highlight any risks associated with that investment – via completing the relevant section of the Operational Risk Assessment (ORA) – before that investment is unconditionally approved;
 - This will be achieved primarily via the **New Investment Group/NIGEL**;
 - The NIGEL will analyse the risks set out in the ORA and determine which risks need to be escalated to the Investment Committee/relevant delegated authority. The NIGEL via its Chair will inform the Risk Committee (RC) of the risks it has identified for the Investment Committee/authorising person to consider, and may also seek input from the RC to form a view on assessing a particular risk; and
 - The full process that the NIGEL follows is available on the NIGEL page on the intranet.
3. We must be commercial and opportune:
 - Lead Investment Professionals must listen to any feedback on a proposal but are ultimately responsible for the commercial terms recommended to the Investment Committee;
 - Where a support team strongly disagrees with a Lead Investment Professional's commercial judgement, the matter is referred to the NIGEL Chair through the ORA. The NIGEL Chair or the RC (as applicable) will provide recommendations (if necessary) to the relevant delegated authority before the initiative is undertaken.

Investment support teams must ensure they facilitate investment activities as best they can within the clear performance expectations set.

4. We will adhere to our established due diligence protocols:
 - The New Investments Toolkit (also known as the Investment Implementation file) is the document of record summarising the non-investment due diligence for a new investment or when there are material changes to existing key terms. The ORA is part of this document;
 - The authorising person gives the final signoff of the Investment Implementation File to permit funding; and
 - The RC tracks the implementation of mitigants identified in the ORA.
5. We will learn from new investment implementations:
 - The Lead Investment Professional will undertake a review of the implementation process once the investment has been executed; and
 - The RC periodically reviews how well the new implementation process is operating.

As appropriate, the same principles apply when we terminate a manager appointment.

Approved by Chief Executive on 11 September 2012 and amended on 5 December 2014, 28 June 2018, and 3 March 2020

Schedule 6: Reporting Framework

Report	Frequency required and to whom	Information required	Accountability
First time commitments to Collective Investment Vehicles (CIV)	Reported to subsequent IC and Board meetings.	<ul style="list-style-type: none"> • CIV name; • Amount committed; • Relevant strategy or sub-strategy. 	CIO
Manager appointment	Reported to Board six monthly and under no surprises protocol.	<ul style="list-style-type: none"> • Manager name; • Relevant opportunity 	CIO
Manager performance	Annually to the Investment Committee	<ul style="list-style-type: none"> • Amount invested or committed per manager • Performance year to date and since inception. • Aggregate performance by strategy together with performance attribution. 	Head of relevant access point team
Material manager non-compliance	Reported to subsequent RC and Audit Committee (AC) meetings.	<ul style="list-style-type: none"> • Details of non-compliance; • Remedial action taken. 	CIO
Manager terminations	Reported to subsequent IC and six monthly to Board and under no surprises protocol.	<ul style="list-style-type: none"> • Name; • Relevant opportunity; • Reason. 	CIO
Disposal of entire interests in CIVs	Reported to subsequent IC and six monthly to Board and under no surprises protocol.	<ul style="list-style-type: none"> • CIV name; • Amount disposed; • Relevant opportunity; • Reason. 	CIO
Manager conviction assessments	Reported at least once a year to either 1) CIO and GM Finance and Risk or 2) the Investment Committee.	<ul style="list-style-type: none"> • Schedule of managers • Latest conviction 	Head of EIP
Material amendment to Policy Statement	Reported to subsequent IC and Board meetings.	<ul style="list-style-type: none"> • Relevant details; • Reason. 	CIO
Adverse issues at manager	If reputational, immediately to Head of Communications. If legal, immediately to General Counsel. To subsequent IC. Regular status updates as necessary.	<ul style="list-style-type: none"> • Full relevant details 	All Investment, Portfolio Risk and Compliance staff
Material changes to CIV or Investment Management Agreement (IMA)	Reported to subsequent IC and Board meetings	<ul style="list-style-type: none"> • Relevant details 	CIO
Non-material changes to CIV or IMA	Reported to the Chief Investment Officer	<ul style="list-style-type: none"> • Relevant details 	Head of EIP
Appointment to represent GNZS on committee, board or similar body of CIV	Report to the next regular meeting of the IC following decision. 6 monthly reporting to the Board of all external committees or bodies on which the Guardians is represented and under the no surprises protocol	<ul style="list-style-type: none"> • Relevant details 	CIO
Breach of this policy	If material: immediately to RC and AC Otherwise: to Head of Internal Audit via a Learning Opportunities Form	<ul style="list-style-type: none"> • Relevant details • Remedial actions taken • Lessons learned for future conduct 	If material: Head of Internal Audit Otherwise: Head of relevant access point team
Material changes to Schedules of this policy	Reported as part of the annual SIPSP review to the Risk Committee and Board meetings and under the no surprises protocol.	<ul style="list-style-type: none"> • Details of change and reasons for change. 	CIO

Approved by Board on 13 June 2011 and amended 5 December 2014, June 17 2015, and 21 January 2020

Schedule 7: Legislative Compliance

The list of New Zealand legislation set out below does not purport to be comprehensive or to provide legal advice. If you require any advice on these matters please contact the Legal team.

When undertaking activities covered by this policy, legislative considerations must be taken into account and complied with. The following legislation is not an exhaustive list as every investment will have legislation governing the activity and this may be different depending on the particular jurisdiction relevant to the activity.

Most countries have restrictions on foreign investment in their country which require the foreign investor to obtain consent before investing.

When contemplating entry into an externally managed investment we need to consider the legislation below carefully as some compliance requirements are triggered right at the start of a transaction even before we engage in negotiations with other parties.

Our governing legislation

- Crown Entities Act 2004
- New Zealand Superannuation and Retirement Income Act 2001
- Venture Capital Fund Act 2019

Legislation specific to transactions

- Anti-Money Laundering and Countering Financing of Terrorism Act 2009
- Companies Act 1993
- Commerce Act 1986
- Contract and Commercial Law Act 2017
- Fair Trading Act 1986
- Financial Advisors Act 2008
- Financial Markets Authority Act 2011
- Financial Markets Conduct Act 2013
- Financial Service Providers (Registration and Dispute Resolution) Act 2008
- Insurance (Prudential Supervision) Act 2010
- Overseas Investment Act 2005 and Foreign Acquisitions and Takeovers Act 1975 (establishing the Foreign Investment Review Board in Australia)
- Property Law Act 2007
- Reserve Bank of New Zealand Act 1989
- Secret Commissions Act 1910
- Takeovers Act 1993 and Takeovers Code, NZX listing rules
- Hart – Scott – Rodino Act (US)

Tax and Accounting legislation

- Financial Reporting Act 2013
- Goods & Services Tax Act 1985
- Income Tax Act 2007
- Tax Administration Act 1994
- Foreign Account Tax Compliance Act (FATCA) (US)

C2 - Internal Use Only

Other

- Copyright Act 1994
- Official Information Act 1982. Our obligations in respect of this Act are covered in the Communications Policy.
- Public Records Act 2005. Our obligations in respect of this Act are covered in the Communications Policy.

Investment Vehicle Structure

Compliance with the relevant governing legislation of any investment vehicle in which the Fund is invested is necessary. Particular advice is required in respect of the requirements of each vehicle and in this schedule, we only refer to the potential type of vehicles and their governing legislation.

- Co-Operatives - Co-Operative Companies Act 1996
- Companies - Companies Act 1993
- Incorporated Societies - Incorporated Societies Act 1908
- Insurance Companies - Insurance (Prudential Supervision) Act 2010
- Life Insurance Vehicles - Life Insurance Act 1908
- Limited Partnerships - Limited Partnerships Act 2008
- General Partnerships - Partnership Act 1908
- Managed Investment Schemes – Financial Markets Conduct Act 2013

Further information

Further information about the relevant sections of the legislation listed above can be obtained from our General Counsel.

Approved by Chief Executive on 5 February 2013, 2 July 2015, 8 December 2016, 28 June 2018, and 3 March 2020