Derivatives Policy

Date:	Policy Takes Effect: August 2016
Approved:	Mint Asset Management Board Resolution
Responsible Officer:	Chief Executive Officer
Relevant To:	All Mint employees - this includes fixed term and temporary or contract employees and contractors and Directors of Mint

Version	Date	Modifier	Document Changes
1	August 2016	Simon Haworth	Initial Policy
2	July 2018	Simon Haworth	Update to include Interest Rate and Currency Swaps and reallocate CIO responsibilities to the Head of Investments

1. Introduction

This Derivative Policy (Policy) has been designed to outline the guiding principles and restrictions around the use of financial derivatives by Mint Asset Management (Mint) in its role as manager of wholesale and retail funds (Funds). Senior management shall be responsible for assisting Mint's Board in the implementation of this Policy.

This Policy has been approved by the Board.

2. Overview of derivatives

Derivatives are specific types of instruments that derive their value over time from the performance of an underlying asset: e.g. equities, bonds, commodities. Derivatives include a wide range of instruments including but not limited to forwards, futures, options, swaps, swaptions. A derivative is traded between two parties (known as counterparties) and each party is subject to a pre-agreed set of terms and conditions that determine their rights and obligations.

There are two ways that derivatives can be traded, either on or off an exchange:

- **Exchange-Traded Derivatives (ETD):** These are standardised contracts traded on a recognised exchange where trade activity is regulated. The counterparty for Mint would be the exchange, minimising counterparty risk (as exchange traded contracts are backed by all exchange members, not just the specific counterparty). The contract terms are non-negotiable and their prices are publicly available.
- **Over-the-Counter Derivatives (OTC):** These are bespoke contracts traded off-exchange where the specific terms and conditions of the transaction are determined and agreed between the counterparties. As a result, Over-The-Counter transactions are more illiquid and carry a higher degree of counterparty risk.

3. Purpose for using derivatives

Derivatives can be an important tool for prudent investment management. Their proper use should enhance the likelihood of meeting the overall investment objectives of a Fund.

At Mint the use of derivatives within its portfolios is permitted but only where their use is consistent with:

- The investment objective and risk profile of a Fund;
- Disclosures made to investors;
- Governing fund documentation;
- Any legislative or regulatory requirements; and
- This Policy.

Specifically, Mint may employ the use derivatives for the following purposes:

Hedging:

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

Efficient Portfolio Management:

- Gain broad market exposure or exposure to specific securities in a manner that does not create the effect of leverage in the overall portfolio.
- 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.

Under its overarching investment philosophy, Mint uses derivatives principally for Hedging purposes. Examples include owning market index Put options in order to hedge against sudden market volatility, and currency forward contracts to hedge offshore currency exposure back into New Zealand dollars. If a situation arises where it is deemed more efficient to gain an exposure via a derivative (rather than the actual physical investment itself) then this requires prior sign off from the Head of Investments and COO.

4. Permitted derivative instruments

Mint's policy is to restrict the implementation of derivative strategies to those that are widely considered 'plain vanilla' and which are well defined, simple in structure and do not employ leverage or complex contractual terms. These can be traded on an Exchange or Over-The-Counter.

Call Option / Put Option – A call option allows the holder to buy the underlying instrument at a set price during a defined period, while a put option allows the holder to sell the underlying instrument at a set price during a defined period. Options are traded on exchanges or OTC.

Forward Contract – An agreement between two parties that commits one party to purchase and the other to sell the asset or instrument referenced in the contract (e.g. a currency pair) at a specified future date with a fixed price and a specified quantity. Forward contracts are typically traded OTC.

Futures Contract - Standardised forward contracts traded on recognised exchanges. Each exchange specifies the standard terms of futures contracts it sponsors. The exchange effectively guarantees fulfilment of the contracts to both the buyer and seller, thereby eliminating credit risk to both parties. In return, each party posts collateral in the form of a cash margin deposit. Futures contracts can be closed out on or before the delivery date through the use of offsetting contracts.

Swap contracts - Swaps are OTC agreements between two parties to exchange one series of future cash flows for another. Typically, the value of the referenced asset (e.g. interest rates, currencies, equities) will be taken from a publicly available price source. Formal documentation will be executed under an International Swaps Dealers Association Master Agreement (ISDA).

The Board, at its discretion, may approve the use of other types of derivatives.

5. Restrictions on the use of derivatives

Except where clearly specified in the objectives of a Fund and adequately disclosed to investors, the following restrictions apply.

Leverage: The use of derivatives for speculation is expressly forbidden. Derivative structures that incorporate or have the effect of amplification are not permitted. No derivative can exceed the value of the underlying assets, whether that be cash supporting 'long' derivatives or assets supporting 'short' derivatives.

Complex derivatives: The combination of permitted 'plain vanilla' derivatives to create complex or exotic derivatives is not permitted.

Liquidity: At all times adequate liquidity is required to provide for the possibility of termination of the position at fair market value.

Pricing: The value of the trade must at all times be able to be mark-to-market valued by an independent pricing source.

Sale of options: The sale of uncovered options or options that result in substantial or unlimited negative risk are forbidden, except when selling an option offsets an equal and opposite prior position.

6. Counterparty Risk

The main risk is that the other party to the derivative transaction will fail to meet their contractual obligations. To mitigate this risk, the following controls must be followed:

- Where possible ETDs are to be used;
- OTC derivatives must be executed with approved counterparties where the relationship is governed by industry standard agreements such as an ISDA;
- OTC counterparties must have an equivalent credit rating of A- (Standard & Poor's) or higher.
- Futures must be traded on a relevant recognised exchange and must be fully collateralised daily.

7. Monitoring

The use of derivatives on a day-to-day basis at Mint is overseen by the Head of Investments and COO. This includes ensuring that trading is only conducted by appropriately skilled personnel, and that operational procedures are in place for monitoring these positions.

The Board, who have overall responsibility for the governance framework, will be supplied with a derivatives report at each meeting by the Head of Investments or COO providing for the rationale and exposure for each open derivative position.

8. Review

This Policy will be reviewed annually by the Audit, Risk and Compliance Committee (a sub-committee of the Board). Any change to the Policy will require Board approval and, if necessary, those changes notified to stakeholders.

Summary of Derivatives use in Mint Funds and Potential Risks

Derivative Instrument	Eligible Funds	Trade Type	Purpose used	Potential Risk of Loss	Mitigating factor
Index Options (Buy)	Equities, Property, Diversified Income	ETD	Reducing downside market risk (Buy Put) while retaining equity long exposure (= reduce beta)	Loss of premium only	Potential loss known at outset and limited
Currency Option (Buy)	Equities, Property, Diversified Income	OTC	Hedging offshore currency exposure back to NZ$	Loss of premium only	Potential loss known at outset and limited
Currency Forward	Equities, Property, Diversified Income	OTC	Hedging offshore currency exposure back to NZ$	Currency volatility	Forward exposure matched by local value of underlying securities
Index Futures (Buy)	Diversified Income	ETD	Gain efficient exposure to asset class via an index (=reduce costs)	Ability to meet margin calls on futures if index falls	Collateralised fully with cash
Index Futures (Sell)	Diversified Income	ETD	Hedge market movements while retaining long security exposure (=reduce beta)	Ability to meet margin calls on futures if index rises	Collateralised fully with underlying securities
Interest Rate Swaps	Diversified Income	OTC	Reducing duration of the bond component of the portfolio	Interest rate volatility	Collateralised fully with underlying securities
Currency swap	Equities, Property, Diversified Income	OTC	Hedging offshore currency exposure back to NZ$ (alternative to currency forwards)	Currency volatility	Exposure matched by local value of underlying securities