

Version	Date approved	Author	Summary of changes
1.0	14/08/2020	Director of Investments	NA

Generate Liquidity Policy

This document sets out the liquidity policy of Generate Investment Management Limited.

In the preparation of this liquidity policy we have taken note of the recommendations provided by the Financial Market Authority.

Generate's liquidity policy considers many factors including the profile of our current investors, the strategy in which they are invested in, and the assets classes that their investments are exposed to.

We consider the nature of investor redemptions in both normal financial market conditions and in times of financial market stress.

This liquidity policy has been reviewed and approved by the Board of Directors and Senior Management of Generate Investment Management Limited.

Liquidity risk

Liquidity risk in the funds management industry can be categorised into two categories, which are both closely related:

- i. Funding liquidity risk
This risk appears when redemption requests from investors in a fund cannot be fulfilled as there is not enough cash, or assets that can be quickly liquidated in the fund.
- ii. Market liquidity risk
This is the risk that the financial market conditions have deteriorated such that assets held within a fund are not able to be liquidated into cash to fulfil redemption requests.

Considerations in determining appropriate liquidity levels

KiwiSaver

KiwiSaver is a voluntary retirement savings scheme. However, once members have "opted-in" to the scheme they cannot withdraw their funds until they are aged 65 years, unless there are unique and specific circumstances. These circumstances are financial hardship, withdrawing funds for a first home purchase, serious illnesses or life-shortening congenital conditions. Members are able to transfer between KiwiSaver Schemes at any time.

First home withdrawals are available to eligible members. Eligible members are permitted to withdraw their KiwiSaver balance, except the last \$1,000, for their first home purchase. Eligible members are a small subset of the KiwiSaver population. Generate maintains timely and accurate records of first home withdrawals from Generate.

When a member transfers out of Generate to another scheme this results in a withdrawal from Generate. The cash balance of the member's holdings must be transferred to the new scheme within 10 business days. Historically net transfers have provided positive cash inflows to Generate. Generate maintains timely and accurate records of transfers in and out of Generate.

KiwiSaver member contributions are a function of the member contributing either 3%, 4%, 6%, 8% or 10% of their salary into their KiwiSaver fund. Additionally, the member's employer contributes at least 3% of gross salary.

The application process for withdrawals owing to financial hardship follow a robust process. The approval of an application is generally only granted where the use of KiwiSaver assets are a last resort for the client. Generate maintains timely and accurate records of financial hardship applications and the number which are granted. This information feeds into Generate's liquidity requirement calculations, discussed below, and is also used to help forecast hardship applications in times of broad economic stress.

Similar to financial hardship withdrawals, Generate records and monitors the level of withdrawals under the first home buyer scheme. There are two additional factors to note here:

- i. Once a member's funds have been withdrawn under such an application the members contributions from both her and her employer continue as before.
- ii. Unlike applications for financial hardship assistance, in times of broad economic stress it may actually be the case that applications for first home purchases actually decrease as the economic uncertainty may reduce housing transaction levels.

By the nature of KiwiSaver's design and rules, liquidity requirements are generally low compared to traditional investment funds that allow investors to freely make applications and redemptions.

Asset quality

When considering the quality of assets within a portfolio it is necessary to understand the nature of that asset's liquidity. In the United States for example, large capitalisation companies are highly liquid in nature with many millions of shares trading per day.

In New Zealand and Australia, on-market liquidity is lower than that of the United States. This is especially true for stocks that are not large capitalisation stocks. Large amounts of market liquidity in New Zealand and Australia sits "off-market". As a result, brokers play a large intermediary role in matching buyers with sellers. A peculiarity of this is that average daily volume measures in New Zealand and Australia may underrepresent actual liquidity available.

Liquidity is also not a static topic. Indeed, many assets endure liquidity "events" which can materially change the quantum of liquidity. This may be as the result of a company growing larger and entering into new indices where larger pools of capital are actively investing, or as a result of the free float of a company growing. Conversely, liquidity could be negatively impacted by a company specific event that reduces the number of shares traded on a daily basis. An example of this could be multiple earnings downgrades which makes a company highly unattractive.

Generate defines assets that are considered to be highly liquid in nature as:

- i. Cash
- ii. Large capitalisation international equities (greater than US\$100 billion)
- iii. Large capitalisation New Zealand equities (greater than NZ\$10 billion)
- iv. Large capitalisation Australian equities (greater than A\$10 billion)

Measuring liquidity risk

Generate has a quantitative liquidity measuring process which tests liquidity in both normal market conditions, and under a "stressed" market situation.

Liquidity testing in a normal environment

Under this scenario the sum of total assets defined as “highly liquid” is calculated and tested against average daily gross redemptions.

To measure liquidity under a “normal” environment Generate uses the historical pattern of average daily flows to or from the funds to assess the current state of available liquidity. These flows include outflows resulting from the transfer of funds from Generate’s KiwiSaver funds to those of competitors, withdrawals for hardship or first home and transfers out to other KiwiSaver schemes.

Given the nature of KiwiSaver as a product as discussed above, and Generate’s growth in funds under management this has led to there being no history of net outflows. Generate monitors these flows on a weekly basis.

Generate assumes that “highly liquid” equity assets can be liquidated on any given day up to 25% of average daily volume. 25% of a single day’s trading volume is considered to be a level that would not be voluminous enough to distort the equity price in a material manner. The sum of theoretically liquidating these equity positions is added to the sum of cash on hand and then divided by the fund size to provide a measure of the immediately accessible liquidity in each fund relative to its size.

For Unit Trust products, unlike KiwiSaver, there is not a reasonable degree of certainty regarding daily inflows therefore the redemption profile under a “normal” environment is more difficult to estimate. At the time of writing, Generate’s sole Unit Trust product has not been open for a full 12-month period. It therefore does not have a fulsome history of redemption patterns. As a result, Generate tests and monitors liquidity available within the fund against a conservative daily redemption assumption of 0.5% of fund size. This is substantively above what the experience has been to date.

Liquidity testing in a stressed environment

Testing under a stressed environment follows similar principles to that of a normal environment. However, it uses a more stringent set of assumptions when determining what degree of liquidity may be required.

In March 2020, global financial markets produced the most extreme set of liquidity testing parameters seen since the Global Financial Crisis. As a result, Generate now uses this event to determine “stressed” environment parameters.

A notable experience of the March 2020 market sell-off was that Generate’s KiwiSaver members made material fund switching decisions from growth strategies to conservative strategies, while investors in the Unit Trust product also made elevated levels of redemptions.

For the purposes of measuring the liquidity within each fund during a stressed environment, Generate uses the maximum daily drawdown experienced within each fund (as a percentage of the fund), and tests whether liquidity exists in the current fund positions to support this, and for how many days that could continue.

To add further rigour to the stress test, Generate assumes that liquidity available in markets declines to the level seen during March 2020. The effect of this materially reduces average daily volumes that the funds could sell into by more than 25% relative to the “normal” environment scenario.

Finally, under this scenario Generate assumes that access to tradable volumes in highly liquid equity securities reduces to 20%.

Generate monitors the output metrics from running this scenario which includes;

- i. required liquidity
- ii. required liquidity relative to immediately available liquidity and,
- iii. days of liquidity coverage

Liquidity flags

Within the quantitative liquidity framework that Generate monitors are two key automated liquidity “flags”.

The first of these is average net daily flows as a percent of highly liquid assets. Where this ratio rapidly increased to a level deemed unacceptable, Generate would address whether the fund in question was required to increased available liquidity levels. As stated above, and dating back to January 2018 there is no current trend of net outflows and as such we do not currently have a hard flag level. However, Generate measures this metric on a weekly basis. At the point in time that Generate starts to experience net outflows the intention is to review and put in place a flagged level.

A second key metric which has the potential to raise a liquidity flag is “days of liquidity coverage”. Where this falls below 5 days, a flag is raised, and additional sources of liquidity may be sourced.

Reporting

Generate monitors changes to each fund’s liquidity profile on a quarterly basis. However, additional monitoring is implemented where market conditions provide a necessity to do so.

The liquidity profile of Generate’s investment funds is reported to and discussed at regular Investment Committee meetings.

The appendix of this document contains images of the quantitative framework underpinning Generate’s liquidity policy, and the reports which are viewed by the Investment Team and Investment Committee.

Appendix

Liquidity Dashboard

30/06/2020

Liquidity monitor - current portfolio								
Portfolio	Fund size	Highly liquid assets	As % of Fund	Average net flows	as % of liquidity available	Days of liquidity coverage		
Conservative Fund	\$ 397,308,244	\$ 71,255,580	17.9%	\$ 614,566	n/a	n/a		
Growth Fund	\$ 674,740,499	\$ 188,282,839	27.9%	\$ 1,043,704	n/a	n/a		
Focused Growth Fund	\$ 864,409,357	\$ 299,853,528	34.7%	\$ 1,337,089	n/a	n/a		
Focused Growth Trust	\$ 5,568,162	\$ 2,128,726	38.2%	-\$ 27,841	1.3%	76.5		
Maximum level of ADV					25%			

Stressed market liquidity scenario								
<u>Assumptions:</u>								
Market liquidity decreases		-27%						
<u>Max drawdown from C-19</u>								
Conservative Fund		0%						
Growth Fund		1.24%						
Focused Growth Fund		1.31%						
Focused Growth Trust		4.82%						
Portfolio	Fund size	Highly liquid assets	As % of Fund	Max. daily gross redemptions	as % of liquidity available	Days of liquidity coverage		
Conservative Fund	\$ 397,308,244	\$ 61,559,461	15.5%	\$ -	n/a	n/a		
Growth Fund	\$ 674,740,499	\$ 152,343,954	22.6%	-\$ 8,366,782	5.5%	18.2		
Focused Growth Fund	\$ 864,409,357	\$ 259,493,759	30.0%	-\$ 11,323,763	4.4%	22.9		
Focused Growth Trust	\$ 5,568,162	\$ 1,863,473	33.5%	-\$ 268,385	14.4%	6.9		
Maximum level of ADV					20%			

Notes:

Highly liquid assets include cash at bank plus up to 25% of ADV of US stocks with mkt cap >US\$200bn, New Zealand stocks with mkt cap >NZ\$10bn and Australian stocks with mkt cap >A\$10bn

Example of input parameters

Focused Growth - Current portfolio				Current portfolio - target cash			
Liquidity sensitivity parameters				Liquidity sensitivity parameters			
% of equity position to liquidate		25%		% of equity position to liquidate		25%	
NZDUSD		0.64		NZDUSD		0.64	
Fund Size	\$	864,409,357		Fund Size	\$	864,409,357	
Liquid assets				Liquid assets			
Cash at bank	\$	82,226,095	9.5%	Cash at bank	\$	43,220,468	5.0%
Equities	\$	217,627,433	25.2%	Equities	\$	217,627,433	25.2%
Total liquidity	\$	299,853,528		Total liquidity	\$	260,847,901	
as % of FUM		34.7%		as % of FUM		30.2%	
Base case							
Equities	Shares	ADV -100 days	Potential fund sales	Cash raised (native)		Cash raised (NZD)	
BABA US EQUITY	92,650	18,912,378	4,728,095	\$ 20,107,830		\$ 31,418,484	
GOOGL US EQUITY	11,547	2,411,132	602,783	\$ 16,405,285		\$ 25,633,257	
BRK/B US EQUITY	263,928	7,794,789	1,948,697	\$ 47,916,128		\$ 74,868,951	
FB US EQUITY	49,794	23,953,716	5,988,429	\$ 11,577,105		\$ 18,089,227	
NVS US EQUITY	205,000	2,558,603	639,651	\$ 17,457,800		\$ 27,277,813	
MSFT US EQUITY	82,544	47,757,296	11,939,324	\$ 15,595,863		\$ 24,368,537	
A2M AU EQUITY	567,354	4,731,087	1,182,772	\$ 9,900,327		\$ 9,900,327	
SPK NZ EQUITY	4,938,916	3,503,318	875,830	\$ 3,840,512		\$ 3,840,512	
MEL NZ EQUITY	2,391,814	1,830,011	457,503	\$ 2,230,326		\$ 2,230,326	
Stress case							
Equities	Shares	ADV -March C-19	Potential fund sales	Cash raised (native)		Cash raised (NZD)	
BABA US EQUITY	92,650	16,401,478	3,280,296	\$ 20,107,830		\$ 31,418,484	
GOOGL US EQUITY	11,547	1,712,754	342,551	\$ 16,405,285		\$ 25,633,257	
BRK/B US EQUITY	263,928	4,533,792	906,758	\$ 47,916,128		\$ 74,868,951	
FB US EQUITY	49,794	16,713,758	3,342,752	\$ 11,577,105		\$ 18,089,227	
NVS US EQUITY	205,000	2,210,267	442,053	\$ 17,457,800		\$ 27,277,813	
MSFT US EQUITY	82,544	29,542,459	5,908,492	\$ 15,595,863		\$ 24,368,537	
A2M AU EQUITY	567,354	4,436,531	887,306	\$ 9,900,327		\$ 9,900,327	
SPK NZ EQUITY	4,938,916	3,501,098	700,220	\$ 3,070,463		\$ 3,070,463	
MEL NZ EQUITY	2,391,814	1,688,445	337,689	\$ 1,646,234		\$ 1,646,234	

Maximum daily draw down experienced during March 2020

	GF	FGF	FG Trust
	-0.45%	-0.39%	-1.71%
	-0.10%	-0.12%	0.03%
	-0.12%	-0.17%	1.96%
	-0.02%	-0.02%	0.24%
	-0.01%	0.06%	0.06%
	-0.02%	-0.01%	0.05%
	-0.08%	-0.09%	0.13%
	-0.40%	-0.26%	0.43%
	-0.31%	-0.38%	0.72%
	-0.57%	-0.65%	-4.82%
	-1.24%	-1.31%	0.01%
	-0.82%	-0.80%	3.74%
	-0.75%	-0.75%	-0.12%
	-0.39%	-0.40%	-3.93%
	-0.30%	-0.47%	-2.98%
	-0.48%	-0.45%	0.24%
	-0.26%	-0.30%	0.02%
	-0.17%	-0.09%	-0.04%
	-0.04%	-0.05%	1.08%
	0.06%	0.05%	2.69%
	0.28%	0.11%	0.00%
	0.16%	0.13%	0.00%
Max drawdown	-1.24%	-1.31%	-4.82%