VANUATU NATIONAL PROVIDENT FUND

VNPF INVESTMENT FRAMEWORK

Issued: August 2019

Contents

VANUATU NATIONAL PROVIDENT FUND

P.O Box 420, Port Vila, Vanuatu – Telephone: (678) 23808 - Fax: (678) 24673 E-Mail: vnpf@vanuatu.com.vu

INVESTMENT GOVERNANCE ARCHITECTURE

(Approved by VNPF Board on 11 September 2019)

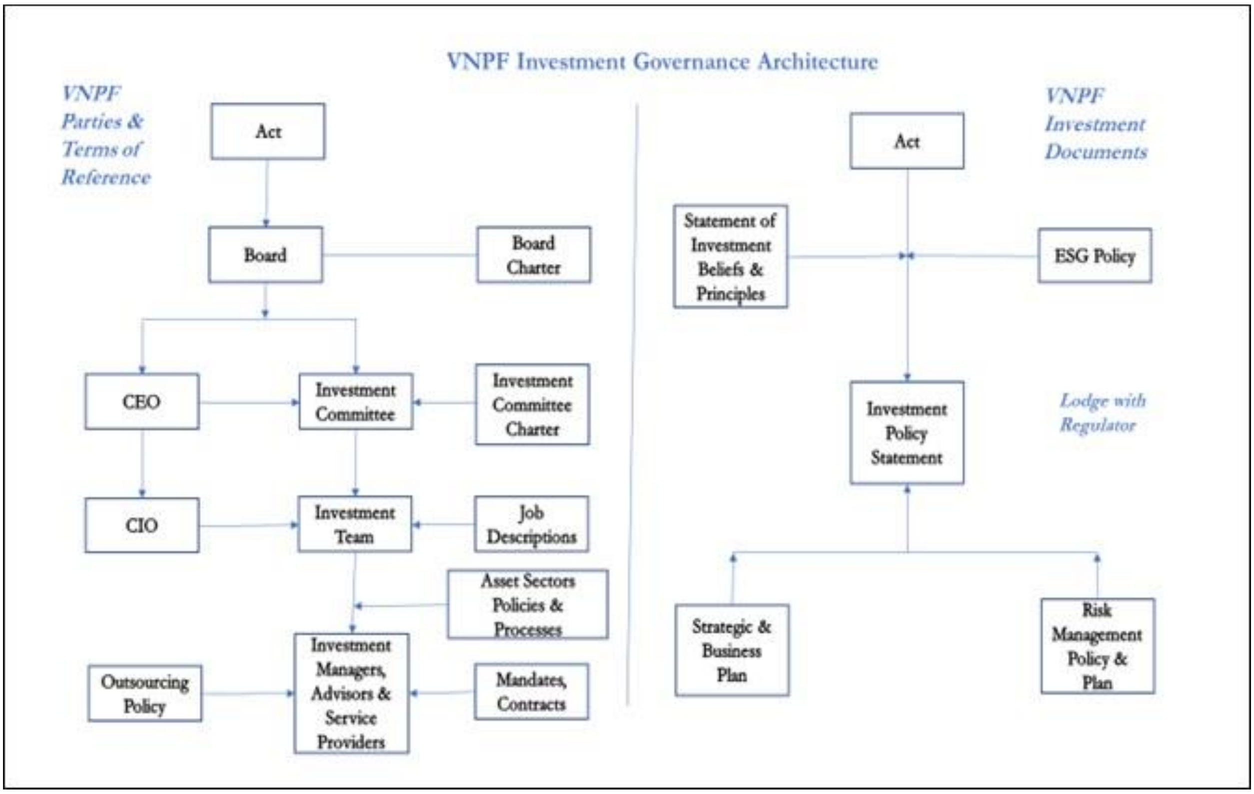
VANUATU NATIONAL PROVIDENT FUND

INVESTMENT GOVERNANCE ARCHITECTURE

1. Purpose

1.1 The Investment Governance Architecture will guide the overall investment processes and set of owned responsibilities that ensure the integrity and effectiveness of the Investment Division.

2. Investment Governance Architecture



VNPF Parties & Terms of Reference

Act

- Establishes VNPF.
- Constitutes Board.
- Defines role as Trustee.
- Sets out powers, obligations & responsibilities, including power to set an investment strategy to achieve the objectives of the Fund.

Regulator

- The Regulator is the Reserve Bank of Vanuatu.
- The Fund will be managed within any prudential standards that may be established by the Regulator.

Board

- Is governed by the Act and reports to the Minister.
- Frames and operates under a formal charter.
- Sets up committees, delegates certain functions to them, obligates them to report to the Board and designs charters to govern their operations that formalize this process.
- Committees improve Board efficiency and allow closer monitoring of certain functions and deeper probing of individual issues.
- The Board retains power to set investment strategy and approve investment policies but operates on the advice of Investment Committee (but is not obligated to follow that advice).
- The Board sets the Fund's investment objective
- The principal focus of the investment strategy will be for it to play its part on the achievement of the Fund's objectives.

Investment Committee (IC)

- Established under Section 16 of the Act
- Operates under formal charter that sets outs duties and expectations
- Knowledge may be enhanced from targeted training.
- The IC is responsible for detailed oversight of the formulation, implementation and reporting of the progress of investment strategy.
- The Chief Investment Officer (CIO) hierarchically reports to the Chief Executive Officer (CEO), who has overall responsibility for Fund performance, but the CIO also reports on the various investment activities under an agreed reporting format.
- The CEO attends all IC meetings.
- There will generally be an approvals process that will be graduated by financial size and nature of issue, but important new investments, divestments and manager and service provider appointments will be first reviewed by the IC, who will make a recommendation to the Board as to whether the Fund should proceed.

Investment Division

- The Investment Division report hierarchically to the CIO.
- The Investment Division will be structured according to the wishes of the CEO and CIO after, if required, approval of the IC and Board.
- Individual officers will operate with accordance with their job descriptions and duty statements.
- Each major asset class will have an accompanying formal policy that will set out the Fund's requirements and expectations of how it will be managed.

Funds Managers & Service Providers

- Will be formally appointed.
- Appointments will be evidenced by contracts and/or investment mandates.
- Contracts and mandates will set out the nature of the activity, expected performance standards, formal review mechanism and the cost of the services.

VNPF Investment Documents

Statement of Investment Beliefs & Principles

- Sets out where the Fund will look for returns.
- Where Board and IC will focus its attentions.
- Sets the principles by which the Fund will invest members' funds.

Environmental Social and Governance (ESG) Policy

- Sets out the processes by which the Fund aims to be a responsible investor.
- Frames investments holistically.
- Sets out the Fund's overall expectations of itself and partners under these headings.

Strategic & Business Plans

- Sets out income and operating expenses budget.
- Outlines major investment projects.

Risk Management Policy & Plan

- Sets Fund's overall risk and investment risk appetites.
- Sets out compliance and risk reporting requirements.

Investment Policy Statement

- Drafted and approved annually by the Board after consideration by the IC.
- Summarizes investment governance architecture.
- Sets out Fund objective and target return for the year ahead, asset allocation, general sector characteristics and contributions to return and risk profile.
- Is examinable by and can be lodged with regulator if requested.
- Is reported against at IC and Board meetings. ,

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INVESTMENT COMMITTEE CHARTER

(Approved by VNPF Board on 11 September 2019)

VANUATU NATIONAL PROVIDENT FUND

INVESTMENT COMMITTEE CHARTER

1. Purpose

1.1 This Investment Committee Charter will guide the overall operation and conducts of the Investment Committee. It sets out the duties and expectations of the Investment Committee.

2. Constitution

2.1 The Board has set up a range of Committees to improve the Board's efficiency and to allow more detailed investigation and discussion of matters that would prove unwieldy for the full Board. Each Committee is constituted as a Committee of the Board and operates within a Board-approved Charter.

2.2 The Board appoints both Committee members and the Chair of the Committee. There will be a minimum of three (3) Committee members in total who are generally appointed for a term of three years. While the Board also has a general policy of encouraging rotation between Committees, this must be done without impairing the Committee's effectiveness. Committee members are chosen from Board Directors according to their knowledge and experience of the relevant topic areas and to ensure a balance of skills appropriate to the work of the Committee. The Board will provide training to Directors appointed to Committees as the need arises.

2.3 The Board may in addition appoint to the IC external independent members to provide particular expertise and to complement the skills of Directors. Such members must be fit and proper persons.

2.4 The Committees analyze and review policies and strategies, usually developed by Management, that are within their charters. The Committees also examine proposals and, where appropriate, make recommendations to the Board. The Committees do not take action or make decisions on behalf of the Board except where they have been formally delegated to do so. Any such delegations are recorded in the Delegations Register and the relevant charter.

2.5 In addition to their formal roles, Committee members are expected to provide counsel and guidance for the operating divisions and officers who report to them.

2.6 All Board members are entitled to attend all Committee meetings or access the papers thereof, but non-Committee members may not vote.

2.7 All conduct requirements that apply to Board members also apply to Committee members.

2.8 In addition, Section 16 of the Act allows the Board to establish an Investment Committee (IC).

2.9 The Board may also co-opt persons with specific areas of expertise from time to time for individual tasks or projects and to evaluate matters as the need arises.

3. Role of the Investment Committee (IC)

3.1 The overall objective of the Committee is to assist the Board in designing the Fund's investment policies, over sighting the execution and ongoing management of its investment portfolio on a prudent commercial basis and without detriment to Vanuatu's reputation, and to help the Fund to meet its return objectives within the risk parameters set for the Fund.

3.2 The functions of the Investment Committee are to:

- Overseeing the development of the Fund's investment strategy and policies, including the Statement of Investment Beliefs, the Investment Policy Statement covering the intended portfolio mix, return and risk expectations and considerations of diversification and liquidity, and policies affecting individual asset sectors,
- Assess and provide recommendations on proposals presented to it by the Investment Division;
- Monitor and provide information and recommendations to the Board in respect of current investments;
- Assess any Fund Managers proposed for appointment and, if satisfied they are appropriate, approve their appointment. Monitor the performance of Fund Managers;
- Receive periodic investment performance reports and economic and market commentaries;
- Decide the level, form and frequency of such reporting;
- Review emerging investment opportunities and help the Board decide on their appropriateness for the Fund;
- Ensure the selection process, appointment and review of material investment service providers, including Fund Managers and custodians, are robust and thorough, operate in the Fund's best interests and are legally reviewed for enforceability and completeness;
- Meet with external advisors and Fund Managers;
- Research best practice within its areas of operation and its application within VNPF;
- Oversee and receive reports on risks identified for its area of operation within the Fund's Risk Management Policy and Plan;
- Review the performance of the Investment Division; and
- Make recommendations to the Board as required.

3.3 With this in mind, the Board authorises the IC to investigate any activity within its scope of responsibilities and to:

- Obtain any information it needs from any employee and/or external party, including counterparties, Fund Managers, custodians or external advisors, subject to contractual requirements;
- Discuss any matters with the Auditor, or other external parties, within confidentiality considerations;

- Request the attendance of any employee at Committee meetings; and
- Obtain external legal or other professional advice, as considered necessary to meet its responsibilities, at VNPF's expense, provided the IC Chair (see section 3 of this charter) has cleared this with the Board Chair.

4. Role of the IC Chair

4.1 The Chair's role is to ensure the effective and efficient operation of the IC. The Chair must cultivate a constructive relationship with the Chief Executive Officer and the Chief Investment Officer.

4.2 The Chair reports to the Board on all matters covered in its meetings by way of draft or approved minutes and must bring to the attention of the Chair of the Board any matter of significant concern arising from the performance of any of its responsibilities immediately such concerns arise. .

5. Proceedings of the IC

5.1 The IC will meet at least four (4) times a year on an agreed calendar.

5.2 Meetings may be conducted by teleconference, video conference or in person.

5.3 Any Committee member may call a meeting of the Committee and the Chief Executive may also request the Chair to call a meeting.

5.4 In respect of IC meetings:

- While the Board expects every Committee member to attend its meetings, any member who is unable to do so must notify the Chair in advance;
- A quorum shall consist of at least two (2) Committee members being present;
- In the event of the absence of the Chair, those Committee members present will elect an Acting Chair;
- A majority vote is required for a resolution to pass;
- The IC maintains a meeting agenda with topic headings that relate to the Committee's responsibilities;
- Committee meetings are formally minuted with Matters Arising noted for future action;
- Substantive matters decided by the IC are recorded in the Material Decisions Register; and
- The Chief Investment Officer acts as Committee Secretary and will ensure minutes and registers are kept in an indexed, accessible and secure form and conveyed to the Board Secretary.

6. Performance Evaluation

6.1 The IC conducts an annual review of its own performance and effectiveness and of individual Committee members and reports its findings and suggestions for improvement to the Board.

6.2 This review includes the appropriateness of the IC Charter and the completeness and mix of skills available to the Committee.

7. Amendment History

Version	**Author**	**When Reviewed by IC**	**When Approved by Board**

VANUATU NATIONAL PROVIDENT FUND

P.O Box 420, Port Vila, Vanuatu – Telephone: (678) 23808 - Fax: (678) 24673 E-Mail: vnpf@vanuatu.com.vu

STATEMENT OF INVESTMENT BELIEFS AND PRINCIPLES

(Approved by VNPF Board on 11 September 2019)

VANUATU NATIONAL PROVIDENT FUND

STATEMENT OF INVESTMENT BELIEFS AND PRINCIPLES

1. Purpose

1.1 The Statement of Investment Beliefs and Principles sets the direction for investment policy and investment practice.

1.2 Define how the Fund as an asset owner will create investment value, in the context of future uncertainty, risk and opportunity. It also help the Fund to make practical decisions about its investment style, the selection and monitoring of investment managers, their investment decisions, performance objectives and their approach to active ownership.

1.3 Internal stakeholders, in particular the Board, senior management and the Investment Division are key to translating investment beliefs into investment practice. It is therefore critical that these stakeholders are closely involved in the process of developing, formalizing and agreeing the final set of approved beliefs.

2. Overall Principles

2.1 VNPF investment strategies, governance framework and policies are guided by the values reflected in these investment beliefs and are designed to manage our funding risk and achieve returns and cash flows that meet our long-term financial obligations.

2.2 Our core mission is to deliver secure and sustainable retirement benefits to our members.

2.3 Our investment strategies and policies are designed to focus on managing risk and achieving returns and cash flows that meet our long-term payment obligations to members.

3. Competitive Advantage

3.1 VNPF is one of the largest pools of investible funds in Vanuatu outside Government, which means that it may be offered opportunities to invest and makes it a desirable investment partner.

3.2 In assessing such opportunities, the Board will always be conscious of the Fund’s primary purpose to pay benefits and will form an opinion as to whether the opportunities satisfy its values, risk appetite and investment criteria, and will improve the Fund’s risk-adjusted investment performance.

4. Investments Goals

4.1 The VNPF aims to earn at positive real returns whilst ensuring adequate security, and is therefore conscious of the effects of inflation on members' benefits. It assesses its performance relative to this goal over period of 5 years or more.

4.2 The IC sets required rates of return for each investment in light of this overriding goal, the nature of the investment and the associated risk, and measures performance relative to that return and risk.

4.3 Achieving our investment goals requires us to assume risk and accept that periodic losses can arise.

5. The Nature of the Vanuatu Economy

5.1 Vanuatu is a small-to-medium island economy in which agriculture, tourism and the public sector predominate.

5.2 Domestic investment opportunities reflect these characteristics, may fluctuate in availability over time, may vary in scale, sometimes have a development character and may be relatively illiquid outside bank term deposits.

5.3 There are as yet no meaningful indices that correspond to the "markets" of developed economies. Market risk for domestic assets will be more defined by nature of the local economy and the assets held will be subject to a reasonable degree of asset specific risk for the foreseeable future.

6. Offshore Investments

6.1 Offshore Investments will, with judicious selection and informed management, generally improve the Fund's portfolio diversification by allowing the Fund to access a broader set of economic activities and deeper financial markets and by the potential impact of foreign currencies.

6.2 The Board acknowledges that offshore investments are only likely to benefit the Fund over the longer term, identifies this as the appropriate investment horizon for its offshore investments and adjusts its investment risk appetite accordingly.

6.3 The Board accepts offshore investments will increase portfolio volatility in the shorter term, especially from the result of currency movements. The Board may choose to hedge its currency exposures in part or in full to reduce the impact of this volatility, which will be assessed at the total portfolio level. In doing so the Board acknowledges that hedging has a cost, it is unlikely that hedging instruments will be available through public markets and the Fund may need to use more expensive, “over-the-counter” instruments. The Board will seek professional advice as required.

6.4 As an additional volatility control, the Board has chosen to limit offshore investments to 15% of the Fund by value and acknowledges that this may restrict the return enhancement and diversification offshore investments otherwise bring.

7. Knowledge and Understanding

7.1 The Board will only invest in assets that it has the capacity to analyze either through its own resources or with the assistance of suitable and trusted experts, so that it understands the sources of return and risk within the assets and can be confident that they meet the Fund’s investment criteria.

7.2 As a learning organization, however, VNPF looks to develop its skills and capacities over time and invests in its systems and people accordingly.

7.3 When the Fund invests offshore, the Board will generally appoint Fund Managers for this purpose given their greater proximity to the relevant markets and ability to be more timely in execution. The Board acknowledges the agency risk inherent in such an arrangement exercises an active oversight of its managers and seeks to ensure an appropriate alignment of incentives between the parties.

8. Beliefs

8.1 No investment should endanger the Fund’s primary purpose to pay benefits.

8.2 This may require holding sufficient liquidity to pay benefits falling due in the short to medium term over and above any other liquidity considerations.

8.3 The amounts and patterns of expected benefit payments set a “term structure” that investment strategies must be mindful of.

8.4 While historical returns may provide a guide to the range of possible returns, investment decisions are forward looking by nature and must have regard to expected returns and risks.

8.5 While diligence is required at all levels of the investment process, returns and risk at the total portfolio level matter most.

8.6 Higher returns generally entail taking higher risk and there should be adequate compensation for taking such risk.

8.7 Diversification across counterparties and sources of return generally adds to portfolio resilience.

8.8 Whenever an investment is made, there should ideally be a feasible means of exiting or liquidating it within an agreed horizon appropriate to the asset in question.

8.9 Markets are never static and new opportunities may emerge from time to time.

8.10 Risk comes in many forms and may vary by asset type and the Fund's investment processes must investigate risk thoroughly.

8.11 The Fund Risk Management Policy and Plan sets out the Fund's investment overall risk appetite.

8.12 Notwithstanding this, the Board will be particularly mindful of the need to pay benefits as they fall due (asset-liability management risk), the need to maintain the real value of member's benefits (inflation risk) and the risk of capital loss (negative returns).

9. Tax and Investment Cost

9.1 Taxation and costs reduce net returns, so the Board pays attention to the management of investment costs, both initial and ongoing, and other outgoings, e.g. withholding and similar taxes.[1] It seeks to ensure the Fund receives value for money and that the returns received justify the amounts expended.

9.2 Within these disciplines, the Board puts more emphasis on returns after costs than on costs as a standalone item.

9.3 Expanding our capital base is an effective way to leverage our investment management teams and offset costs.

10. Reporting

10.1 The Board requires timely, accurate and comprehensive reporting to assess whether its investment strategies are meeting the expectations set for them. This reporting should encompass both return and risk and enable the Board to understand the sources of return and risk and how an individual asset or asset sector is contributing to total portfolio return.

10.2 The Board will put most emphasis on results over the investment horizon it determines most suitable given its asset-liability dynamics.

[1] The Fund is a tax-exempt investor within Vanuatu and will investigate whether sovereign state concessions are avaiable to it in overseas jurisdictions.

11. Environmental, Social and Governance (ESG) Concerns

11.1 As a fiduciary, the Board holds itself to high governance standards, both as an organization and within its investment operations, with an appropriate balance of responsibilities, mix of skills and properly articulated and fit-for-purpose business processes. We also seek to ensure our business and investment partners do so as well.

11.2 As an island nation, Vanuatu is highly exposed to the negative effects of climate change. Moreover, its geography and geology expose it to natural disaster risks to a greater extent than many other countries.

11.3 For these and good citizenship reasons, the Board believes that paying attention to ESG concerns is likely to improve risk-adjusted returns over the long term.

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ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) POLICY

(Approved by VNPF Board on 11 September 2019)

VANUATU NATIONAL PROVIDENT FUND

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) POLICY

1. Purpose

1.1 The ESG policy sets out the principles by which the fund aims to be a responsible investor.

1.2 Responsible investing is widely understood as the integration of environmental, social and governance (**ESG**) factors into investment processes and decision-making.

2. Principles

2.1 The Vanuatu National Provident Fund (VNPF) has a long-term investment horizon by virtue of the nature of its assets and liabilities.

2.2 Being an island state and already prone to cyclones and other catastrophic events, Vanuatu is especially vulnerable to the more pessimistic predictions of the effects of climate change.

2.3 Beyond fulfilling its statutory functions, the VNPF aims to contribute to Vanuatu's economic and social development and for its operation to enhance the nation's reputation.

2.4 As a fiduciary, the VNPF Board holds itself to high governance standards, both as an organization and within its investment operations, with an appropriate balance of responsibilities, mix of skills and properly articulated and fit-for-purpose business processes.

2.5 As an asset owner, the VNPF believes it is generally well placed to exercise a positive influence over on its partners and the entities through which it invests. The Board is mindful, however, that the Pacific Island economies do not yet have the range of resources to employ in this regard that more developed economies have.

2.6 The VNPF believes that investments that satisfy positive ESG criteria are likely to produce better risk-adjusted and more sustainable returns over the long term.

2.7 For these reasons the VNPF will strive to:

- Show by its own actions that is committed to ESG principles by being respectful, ethical, fair, open, transparent and environmentally aware;
- Contribute to the economic empowerment of women and more general social development;
- Choose business partners, especially external investment managers, who share its commitment and whose values align with VNPF's values;
- Include ESG criteria as part of researching and analysing potential investments and conducting contractual negotiations;
- Apply the principles of continuous improvement to its processes in this respect;
- Exercise ownership rights where they exist in a manner that is both responsible and consistent with the principles enunciated here;
- Engage constructively with its own employees and the wider community on ESG issues;
- Develop an annual plan to translate these undertakings into practical actions; and
- Report on progress made on this plan.

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RISK MANAGEMENT STRATEGY

(Approved by VNPF Board on 11 September 2019)

VANUATU NATIONAL PROVIDENT FUND

RISK MANAGEMENT STRATEGY

1. Purpose

1.1 The risk management strategy provides a structured and coherent approach to identifying, assessing and managing risk. It provides a process for regularly updating and reviewing the assessment based on new developments or actions taken.

2.1 This Risk Management Strategy and procedures support the funds Enterprise Risk Management (ERM) Policy and should be read in conjunction with that policy.

2. Risk Management Objectives

2.1 The principal objectives of VNPF's Investment risk management framework are to:

2.1.1 Ensure that VNPF is able to successfully achieve the fund's Investment goals as well as the goals of each of its services, with particular emphasis on benefits to members of the fund.

2.1.2 Manage financial risks to maximize the returns to members, while ensuring that the fund remains solvent.

3. Risk Management Strategy

3.1 VNPF has the following strategy for managing risk across the enterprise:

3.1.1 Funds under management are subject to specific ongoing procedures to manage earnings risk, capital risk, default risk and liquidity risk. The Investment Committee and the Board reviews each of these areas of risk on a quarterly basis for the entire portfolio. These areas of risk are also assessed as part of the request for approval of any new investment.

3.1.2 Each year a detailed risk assessment is performed within each business unit to consider operational risk and compliance risk.

3.1.3 This risk assessment is reviewed on a half-yearly basis to consider any changes in circumstances.

3.1.4 The risk management framework is also reviewed annually to ensure it is still appropriate given the size, business mix, portfolio mix and operating conditions of VNPF and its subsidiaries.

3.1.5 To ensure appropriate accountability and focus on risk management signoffs are required by senior management on the adequacy of risk management processes. These feed up into the signoffs on the risk management framework to the regulator.

4. Sign off on the Risk Management Framework

4.1 The regulator requires the sign-off on the risk management framework to have specific wording: *all material risks have been identified and systems are in place to control and monitor all risks.* This is an onerous declaration as it is never possible to identify or control all risks. As such the following wording is proposed: *best endeavors have been made to ensure that* all material risks have been identified and systems are in place to control and monitor all risks. Best endeavors are defined as a thorough approach to:

4.1.1 Identifying potential material risks based on best information available;

4.1.2 Assessing and analyzing these risks to determine which ones are material;

4.1.3 Evaluating these risks to assess which ones are the highest priority to manage;

4.1.4 Having plans in place to manage material risks to the extent practicable (in other words where the cost of managing the risk is not greater than the probable loss arising from that risk);

4.1.5 Monitoring and reporting on the status of those risks.

4.2 The signoff will be qualified where an area of likely material business risk has not been assessed, or managed at the period of signoff.

5. Specific Areas of Investment Risk Focus and Mitigants

5.1 The nature of VNPF’s business lends itself to certain types of risk on an ongoing basis. As these are standing areas of risk which are implicit in the business, specific standardized procedures have been developed for managing each area of risk.

5.2 The usual definition of investment risk is the statistical probability that the investment will not achieve the desired rate of return.

5.3 This section provides a broad understanding of the key risk issues, mitigants, key policies and controls.

5.4 All investments have inherent risks and typically the higher the risk, the higher the investment return. Portfolio management is concerned with the identification of the overall level of risk/return required, the establishment of a series of control procedures to manage risk, and the effective monitoring and control to ensure that the policy and procedures have been followed.

5.5 In highly traded and liquid markets where price volatility is easier to establish, risk is measured using the standard deviation statistic. Within Vanuatu, the risk statistics are unavailable, so a more approximate approach has been adopted.

a) Market Risk

The risk that an asset class or market experiences adverse performance.

Securities within a single asset class or market will generally behave consistently to a single external market influence. Other asset class/markets may have opposite price movements occurring from the same market influence. This is known as being negatively correlated.

The asset allocation process aims to minimize the portfolio risk from this adverse movement by allocating the investments across different asset classes and markets, for example domestic and international, property, equities, bonds, term deposits. By blending the right combination of asset classes/markets, volatility can be reduced, and the risk level reduced to below the risk levels of any of the underlying asset classes.

Effective asset allocation (rather than specific security selection) is usually held to be responsible for 70-80% of a portfolio’s over-performance.

b) Individual Investment Risk

The risk of failure of a single investment.

Diversification; ensuring that there are multiple investments within each asset class/market reduce risk by minimizing the impact of failure of a single investment or set of linked investments. Within an equity asset class, around 15 different securities is generally considered sufficient diversification.

Within the on-shore portfolio, it is unlikely that this level of diversification will be achieved in any asset class, resulting in a higher risk.

The control required is to ensure that no single exposure exceeds 10% of the Net Asset Value (NAV) of the portfolio.

c) Term Risk

The volatility risk that is implicit in market-priced securities that changes with the term of the investment.

Equity price volatility is high in the short term, but reduces significantly beyond about 3-5 years. Property volatility generally runs in longer cycles tied to the GDP growth. At a minimum, these asset classes must not be considered for an investment timeframe of less than 5-7 years.

Bond price volatility increases for longer dated bonds. The average duration (the technical measure of bond portfolio risk) of the overall bond portfolio must not exceed 5 years.

d) Credit Risk

The risk that credit counterparty is unable to meet its interest or principal payment obligations as they fall due. Where there are multiple linked borrowers , and the failure of one of these borrowers would place the other borrowers at risk, then all borrowers must be treated as if they were a single credit counterparty for risk assessment purposes.

As there is no ratings agency for domestic counterparties, interest-rate product investments may only be made where the counterparty is a financial institution supervised by RBV, and only within individual institution limits expressed both as a Vatu limit and a concentration limit. These limits will be reviewed annually.

Domestic commercial loan assessment, documentation, and on-going loan management requires credit and related skills. Whilst not prohibited by the investment policy, commercial loans should not be a primary offering. Where VNPF wishes to make commercial loans, the Board will recognize the high risk and ensure that controls are in place to mitigate this portfolio risk. This will include full loan assessment and documentation procedures.

Property tenancy defaults have a far lower credit impact; however bank guarantees or rental 3 months in advance to be sought where the tenant does not have a suitable credit history standing.

There is a clear conflict of interest when the Fund takes both a credit exposure and an equity exposure to the same counterparty. This should be avoided, but if not possible, a protocol must be documented to avoid obvious risks.

The credit risk inherent in offshore interest-rate product investments can be reduced by ensuring that all counterparties are rated investment grade or better. Term deposits and cash will only be invested with banks licensed and regulated by the country's financial services regulator. The overall Bond portfolio must be rated A- or better, with no investment being below investment grade.

e) Currency Risk

This is the risk that the movement in the exchange rate of a foreign-currency denominated investment will adversely affect the investment's value in Vatu.

Currency movements are highly unpredictable, and therefore the Fund should not attempt to make gains by taking unhedged currency positions.

There are different ways of hedging currency exposure;

i. Direct hedging, using forward foreign exchange deals to offset an open position. This is no currently available facility to hedge foreign exchange positions back to Vatu.

ii. Natural hedges, where a combination of two or more currency positions effectively offset part or most of a currency's volatility.

The Investment Committee will review the effectiveness of this hedge on a quarterly basis, and if required, change the currency mix.

f) Concentration Risk

The risk that is created by an excess exposure to a particular industry, geographic area, property type, customer type, customer.

Management of an investment portfolio requires both the assessment of individual investment proposals as well as aggregate exposures.

Normal assessment of individual investments including management and financial strength is a separate process from portfolio limits, but the portfolio limits must be the overriding control.

A usual guideline is to ensure than no more than 10% of the portfolio is exposed to any concentrated risk such as counterparty, group of counterparties, industry sectors, asset classes. There are circumstances where this may be excessive, and in a market such as Vanuatu where there are limited investment opportunities, it may be too small.

This guideline does not mandate a set of limits, but rather requires the Board to develop a set of limits suitable for VNPF. .

Safeguarding against risk concentrations should form an essential component of risk management strategies.

Adherence to the limits should ensure:

i. A well-diversified portfolio within a desired risk appetite

ii. A reduction in the likelihood that related exposures will be adversely affected by concurrent changes in conditions

iii. Exposure to individual locations or regions is controlled

g) Earnings Risk

Earnings Risk is defined as the risk that yields will decrease due to market factors. The level and nature of earnings risk depends on the nature of the particular investment for example:

1. Interest bearing securities are subject to interest rate risk
2. Properties are subject to rental rates and vacancy rates
3. Equities are subject to yield changes as a result of changes in underlying earnings.

Earnings risk is managed through the following mechanisms:

1. The Investment Committee and the full Board reviews all investments on a [quarterly] basis for forecast and actual yield
2. New Investments have their earnings risk assessed before making an investment. This risk assessment is reviewed and signed off by the Investment Committee.
3. The majority of interests bearing securities are on fixed term interest rates rather than floating.
4. The Approved Investment Policy Guideline sets upper and lower limits for each investment class to ensure appropriate diversification in line with the Fund's risk appetite. Excessive concentration of investments within a single asset class is prohibited.
5. Excessive concentration with a single counterparty is prohibited in the Approved Investment Guidelines.
6. The Investment Committee reviews the maturity profile of each investment class to monitor the projected returns on the fund.
7. The Investment Committee reviews asset allocation and maturity on a [quarterly] basis to ensure it is in compliance with the Approved Investment Guidelines.

h) Capital Risk

Capital risk (sometimes known as market risk) is defined as the risk that the value of an investment will decrease due to market factors. The level and nature of capital risk depends on the nature of the particular investment for example:

1. For equities there is a risk that stock prices will change.
2. For fixed interest securities there is a risk that their market value will change if not held to maturity.
3. For foreign investments there is a risk that the carrying or recovery value of the asset will decrease as a result of changes in foreign exchange rates.
4. For commodities (e.g. grains, metals, energy) there is a risk that commodity prices will change.

The Fund has a low tolerance for capital risk and therefore has maximum thresholds in the Investment Guidelines for asset classes which are subject to capital risk.

Capital risk is managed through the following mechanisms:

1. New Investments have their capital risk assessed before making an investment and recommendations put in place to manage capital risk. This risk assessment is reviewed and singed off by the Investment Committee.
2. The Approved Investment Policy Guideline sets upper and lower limits for each investment class to ensure appropriate diversification in line with the Fund's risk appetite. Excessive concentration of investments within a single asset class is prohibited.
3. Excessive concentration with a single counterparty is prohibited in the Approved Investment Guidelines.
4. The Investment Committee reviews the market value of all investments on a [quarterly] basis. (Valuations are undertaken on a two-yearly cycle of illiquid assets).
5. The Investment Committee reviews asset allocation on a [quarterly] basis to ensure it is in compliance with the Approved Investment Guidelines.

i) Default Risk

Default risk (also known as credit or counterparty risk) is the risk of financial loss resulting from the failure of a debtor, for any reason, to fully honor financial or contractual obligations to an institution. Default risk also considers the liquidity and solvency risk of a counter party. The level and nature of earnings risk depends on the nature of the particular investment for example:

1. For financial securities there is a risk that the financial institution may not have sufficient liquidity to pay the principal and interest when it falls due.
2. For property, there is a risk that the tenant may not have sufficient liquidity or solvency to pay their rent.
3. For a loan, there is a risk that the borrower is unable to repay.

Default risk is managed through the following mechanisms:

1. New Investments have their default (credit) risk assessed before making an investment and recommendations put in place to manage and contain default risk. Up-front mechanisms would normally include:
    - Selecting counterparties with excellent standing and credit ratings
    - Where credit rating information is not available, a credit risk assessment is undertaken considering such aspects as cash flow and balance sheet strength.

- Seeking to be paid in advance where practical and/or relevant (eg. Property leases)
- Security deposits where appropriate.

2. This risk assessment and credit ratings are reviewed and singed off by the Investment Committee.

- The Approved Investment Policy Guideline sets upper and lower limits for each investment class to ensure appropriate diversification in line with the Fund's risk appetite. Excessive concentration of investments within a single asset class is prohibited.
- Excessive concentration with a single counterparty is prohibited in the Approved Investment Policy Statement/Guidelines.
- Aged debtors analysis is maintained for all debtors, and action taken if payments fall into arrears.
- The Investment Committee is advised on possible defaults on any investment in arrears and bad and doubtful debts on a [quarterly] basis.
- The Investment Committee reviews asset allocation on a [quarterly] basis to ensure it is in compliance with the Approved Investment Guidelines.

3. For loans to members the following procedures are in place:
    - Any borrowings are secured against their own deposits
    - Members are only allowed to borrow up to 25% of their deposit balance
  - Repayments are not to exceed 29% of the applicant's net income.

j) Liquidity Risk

Liquidity risk is the risk arising as a result of redemptions being greater than the amount of liquid assets, leading to forced liquidation at sub-optimal prices or returns, or an inability to return funds to members when desired or an excess of cash which reduces portfolio return. Liquidity risk is managed through the following mechanisms:

1. Strict conditions are imposed for the withdrawal of funds by members ie.
    - Retirement
    - Death
    - Disability
    - Migration
    - Loans (no more than 85% of an individual's investment account balance)

2. Cash flow forecasts are made which estimate the likely cash requirements of the fund on a monthly basis considering:

- Inflows resulting from contributions, and
- Inflows arising from maturing investments, and
- Expected outflows arising from withdrawals by members and the Board will require two cash flow statements;
    I. Annually, a long-term cash flow forecast for 10 years with a sensitivity analysis for key economic assumptions
    II. Quarterly, a short-term cash flow forecast for the following 12 months based on the existing investment portfolio, expected investment requirements, maturities and free cash flow.

3. The investment strategy allows for sufficient cash to be available to meet these requirements, plus additional reserves of cash for unanticipated spikes in demand for withdrawal.

4. Liquidity risk is considered and factored in before making any changes to the redemption requirements by members or introducing new business lines.

5. A formal contingency plan is to be developed and periodically reviewed for dealing with a liquidity crisis. As execution of this plan would require involvement of the Reserve Bank of Vanuatu. This plan is developed with their input and reviewed by them as part of their prudential supervision.

k) Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes but is not limited to risk areas such as:

1. Internal fraud, misappropriation of assets, tax evasion, intentional mismarking of positions, (bribery)
2. External Fraud, theft of information, hacking damage, third-party theft and forgery

3. Employment Practices and Workplace Safety - discrimination, workers compensation, employee health and safety;
4. Clients, Products, & Business Practice, market manipulation, antitrust, improper trade, product defects, fiduciary breaches, account churning;
5. Damage to Physical Assets, natural disasters, terrorism, vandalism;
6. Business Disruption & Systems Failures, utility disruptions, software failures, hardware failures;
7. Execution, Delivery, & Process Management, data entry errors, accounting errors, failed mandatory reporting, negligent loss of client assets;

Each manager and staff member is responsible for managing operational risk on a day to day basis. In addition, operational risk is assessed periodically as part of the ERM process of the Fund. This is also supported by the processes for Control Self-Assessment and Business Continuity Planning.

The following are required controls:

i. No new investment product type, market or currency to be entered into without Board approval supported by documented accounting and operations policies and practices including valuation data sources and valuation formulae.

ii. No new bank accounts to be opened without Board approval

iii. Real property and domestic equities investments to have an agreed management plan, accountability structure and communications plan in place.

iv. Delegated authorities list to be approved by Board, and HR policy updated to ensure that all staff members with delegated authority understand the extent of their authority and the penalties for any breach.

v. Segregation of duties is implemented to ensure that no single staff member, acting alone, can commit VNPF to an unauthorised transaction.

vi. All accounts are reconciled monthly. Unreconciled amounts are properly aged and reported to the Investment Committee.

vii. Documents are retained off-site for a minimum of 10 years.

l) Strategic Risk

Strategic risk is defined as the risk of a loss arising from a poor strategic business decision. This would typically include risks such as:

1. Being in the wrong business at the wrong time
2. Not being in the right business at the right time
3. Being out of step with emerging conditions
4. Failing to focus on the ultimate purpose of the organization
5. Not being able to continue the current business model

Strategic risk is considered as part of VNPF's strategic planning process both as an input to the strategic plan and as an output of the plan. A session on strategic risk is also held periodically with the executive team and the board.

m) Project Execution Risk

The risk that poor project management practices and controls incur unnecessary costs and delay, and as a consequence, forecast returns cannot be achieved. This is usually an issue with property development projects, although development equity projects will be similar.

To ensure that management has sufficient capacity to control these projects, no more than 2 development projects can be undertaken at the same time.

Three key controls to be employed:

a) A three-stage approval process for all property development projects that requires:

i. Budget approval for a feasibility study leading to preliminary investment justification;

ii. Separate budget approval following stage 1 for detailed design, costing and conditional tenancy requirements to leading to a final investment justification

iii. Separate budget approval following stage 2 for the construction budget.

iv. No variations to be approved by the project team without documented submissions and approval by the Board or delegated authority level.

v. Standard project management practises to be employed covering work-in-progress payments, monthly progress reporting including estimated cost to complete and time to complete.

n) Management and Compliance Risk

The Board will monitor and review monthly:

i. the Fund's investment performance against benchmarks;

ii. that asset allocation, currency allocation, risk allocation and other approved controls are within the limits contained within this policy;

iii. that there is full compliance with the prohibitions and restrictions contained within the Act and this policy.

VANUATU NATIONAL PROVIDENT FUND

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INVESTMENT POLICY STATEMENT

(Approved by VNPF Board on 11 September 2019)

VANUATU NATIONAL PROVIDENT FUND

INVESTMENT POLICY STATEMENT

1.0 PURPOSE

1.1 The purpose of the investment policy statement is to document the investment plan and provide guidance for consistent, informed decision-making.

2.0 SCOPE OF STATEMENT

2.1 The Investment Policy Statement 2019 sets out the ways in which the investment portfolio of the Vanuatu National Provident Fund (VNPF) will be managed for the 2019 financial year, taking account of:

- Governance and control processes,
- Investment beliefs and principles,
- VNPF's investment goal,
- Portfolio structure,
- Expected return and risk, and
- Liquidity needs.

2.2 Copies of this statement are available for inspection by the Minister and Reserve Bank of Vanuatu.

1.3 Should economic and investment conditions, or the Fund's overall circumstances, depart substantially from those expected at the time this Statement has been prepared and such that its achievement becomes doubtful, the Chief Executive Officer (CEO) and Chief Investment Officer (CIO) will propose to the Board, through the Investment Committee, changes to this Statement for discussion and approval that they believe are necessary in the circumstances.

3.0 GOVERNANCE

3.1 The Vanuatu National Provident Fund (VNPF) operates its investment program within a defined Investment Governance Architecture (IGA), which is set out in detail in the document that bears this title.

3.2 In general, the Fund aims for a policy- and strategy-driven approach to its investment program, but keeps its policies and strategies under continuous review to ensure the polices and strategies remain appropriate, effective and responsive, where they need to be, to a dynamic environment.

3.3 Roles and responsibilities are allocated to various parties and may be summarized as:

- Board
  - Approves investment policies;
  - Sets investment strategy;
  - Receives reports from the Investment Committee.
- Investment Committee
  - Operates under delegation from the Board;
  - Conducts detailed oversight of the formulation, implementation and reporting of the progress of the investment strategy.
- Chief Executive Officer (CEO) and Chief Investment Officer (CIO:
  - The CEO bears operational responsibility for all aspects of the Fund's operations;
  - The CIO reports hierarchically to the CEO, is the Fund's principal investment strategist and oversees the operation of the Investment Division.
- Investment Division:
  - Day-to-day implementation of the investment program; and
  - May be organized into sector teams or other units of focus and expertise.

4.0 INVESTMENT BELIEFS & PRINCIPLES

4.1 These are set out in detail in VNPF's Statement of Investment Beliefs and Principles.

4.2 They may be summarized as:

- No investment should endanger the Fund's primary purpose to pay benefits as they become due;
- The Board recognizes that this may imply a term structure for investments and a need for liquidity at key points in the Fund's evolution;
- The Board's focus will be on:
  - Returns and risk at the total Fund level,
  - Returns after taxation and other costs,
  - Ensuring value-for-money when it incurs costs;
- History will provide lessons but investment decision making must be forward looking;
- The Fund must monitor the investment environment to ensure the adequacy if its strategies and to be aware of the different opportunities that may emerge over time;
- The Fund should be aware of any relationship between return and risk and should receive adequate compensation for the risks embedded in its investment program;
- The Fund will only invest in assets it has the capacity to analyze appropriately either through its own resources or the assistance of appropriately qualified and motivated advisors;
- There are many kinds of risk which require detailed analysis but the Fund will generally prioritise:
  - Agency risk - ensuring rewards to and incentives for advisors and managers reflect the Fund's needs;
  - Asset-liability management risk - the need to bay benefits as they fall due;
  - Inflation risk – the need to maintain the real value of members' benefits;
  - Concentration risk – diversification across geographies, counter-parties and sources of returns generally add to portfolio resilience;
  - The risk of capital loss - longer return negative returns;
- Opportunities in Vanuatu are likely to reflect the nature of its economy;

- The Board has limited its offshore investments to 30% of the Fund by value, notwithstanding the constraint this limit places on diversification and
- Staging the implementation of the Fund's Environmental, Social and Governance Policy consistent with the Fund's growing capabilities.

5.0 INVESTMENT GOALS

The VNPF aims to credit members with **positive real returns** (greater than local inflation) **over periods of 5 years or more**. Positive real returns

6.0 REFERENCE PORTFOLIO & ASSET ALLOCATION

6.1 The Reference Portfolio indicates the general structure and longer-term risk-return profile the VNPF will aim for in the management of its investment portfolio.

6.2 The VNPF may depart from the Reference Portfolio from time to time but it is expected that the risk-return signature of the Fund will be no worse than that indicated by the Reference Portfolio. This will also be the case for liquidity and other important portfolio characteristics. Any departure must be justified by the economic and investment conditions applying at the time of departure, be in the best interests of members and be communicated through the Investment Committee and Board, who will have a right of approval over same.

6.3 Notwithstanding the above, the Fund will generally be managed within the asset allocation ranges shown in the following table.

6.4 The Reference Portfolio is:

Location	Benchmark	Range	Asset Classes	Benchmark	Range
Vanuatu	80%	70-90%	**Equity**	25%	15-45%
			Fixed Interest	20%	10-40%

			& Cash		
			Commercial Loans	10%	5-20%
			Property	15%	10-25%
			Infrastructure	10%	0-20%
Offshore*	20%	10-30%	**Equity**	4%	0-20%
			Fixed Interest	10%	0-20%

***Offshore exposures will be 50% hedged. This may include property and infrastructure.**

6.5 The expected return for the Reference Portfolio held at the various asset class benchmarks over the longer term is 8% and 4% real respectively[2].

7.0 LEGACY PORTFOLIO

7.1 The Fund's current asset allocation is as follows:

Location	Asset Class	Share of Portfolio
Vanuatu	Equity	18%
	Government Bond	11%
	Commercial Loans	13%
	Property	16%
	Term Deposits	25%
	Cash	12%
Offshore	Equity*	2%
	Fixed Interest**	3%

***Units held in the Unit Trust of Fiji.**

****FX Term Deposits held in Vanuatu.**

[2] These are current estimates but are subject to revision as more data emerges

7.2 The Board acknowledges that the current portfolio was not constructed under current policies and conditions and reflects past asset purchases and investment practices. As such the portfolio is not readily reconcilable to the Reference Portfolio.

7.3 The VNPF aims to transition to a Reference Portfolio approach over the next 3-5 years but acknowledges the process and timing of the transition will depend on:

- Markets conditions generally and for the assets it currently holds,
- The cashflows and sales proceeds it receives from those assets, and
- Member contributions which will be invested according to the Reference Portfolio approach.

8.0 EXPECTED ECONOMIC, INVESTMENT CONDITIONS & ASSET ALLOCATION FOR THE YEAR AHEAD

8.1 The Board expects the economy to display the following characteristics:

Location	Economic Statistic	Rate
Vanuatu	GDP growth	3%
	Inflation	2.5%
	Short Term Interest Rates	0-2%
	Long Term Bank Commercial Lending Rates	17-20%
	Bank RoE	5-10%
	Currency	No significant disturbance
	VNPF Net Cashflow Growth	Positive
Global	GDP Growth	3.25%

8.2 In general, the Board anticipates a slowing world economy and with no resurgence in inflation. This will likely reduce offshore returns to below longer-term norms and will have economic, trade, visitation and return consequences for Vanuatu. Most international commentators see it as more likely that the world economy will underperform, rather than outperform, forecasts.

8.3 With this in mind and considering the current portfolio, the Board is targeting the following asset allocation over the next 12 months:

Location	Asset Class	Weight	Expected Return
Vanuatu	Equity	20%	5%
	Government Bond	10%	7%
	Term Deposits	20%	2%
	Loans	12%	6%
	Property	20%	2*%
	Infrastructure	3%	8%
	Cash	5%	1%
Offshore	Equity	5%	6%
	Fixed Interest	5%	3%

***The current Property portfolio is being affected by vacant land, underpayment of rents and negative valuation adjustments. While progress is expected, it will take time to improve returns.**

8.4 The Board intends principally to use positive net cashflow to reorient the portfolio towards its preferred longer-term shape. It will deal with the legacy portfolio mostly on an asset-by-asset basis, seeking to remediate asset performance where applicable and/or exit where it is opportune and a better use of Fund moneys to do so. It may also redeem term deposits to help fund the growth in offshore exposures. This growth will improve the diversification of the portfolio, notwithstanding the tighter environment offshore. The Board expects a portfolio return of 4% and 5% (1.5% and 2.5% real) over the next 1 and 5 years from these changes.

9.0 LIQUIDITY

9.1 Liquidity is assessed at the Fund level and the asset level.

9.2 Adequate liquidity at the Fund level ensures it is able to meet benefit obligations that fall due from time to time and its normal operating expenses without the need to sell or realize assets in an untimely manner.

9.3 As part of its asset liability management analysis, the Fund predicts the flow of contributions, investment income and benefits over periods up to 10 years in terms of those expected in the normal course of operations and under stressed scenarios such as a Government redundancy campaign or a pandemic. Where benefits exceed contributions and income, the Fund seeks to ensure it has sufficient cash, maturing deposits or realizable assets available to it to meet any shortfall. The Fund will also consider what impacts such circumstances might have on its residual asset allocation. This analysis is undertaken at least annually.

9.4 As noted above, there may be circumstances where the realization of an asset is required to ensure overall Fund liquidity. Liquidity at the asset level is afforded by the existence of secondary markets or other facilities that will allow the realization of an asset. Once the existence of such markets or facilities is established, the Fund then examines the speed and terms with which such realization might occur, both those expected in the normal course of operations and under stressed scenarios. This analysis supports the Fund level analysis, informs asset class exposure limits amongst other things and is undertaken at asset purchase and at least annually. For each asset class, and individual asset if large enough and considered relevant, the Fund will assess:

- Whether a formal or informal secondary market exists;
- Whether there are other holders of such assets in Vanuatu who might be approached to buy or swap assets, for example, under what circumstances and under what conditions;
- Whether other means might be investigated to provide the desired liquidity, e.g. breaking a term deposit or requesting a Government bond buy-back, and under what conditions and at what cost;

- Contractual restrictions and freedoms as the case requires;
- How liquidity varies by asset class and through time; or
- Any other matter it considers relevant.