RESERVE BANK OF FIJI

FNPF Supervision Policy Statement No. 2:

Asset Investment Management Policy for the Fiji National Provident Fund

July 2007

1.0 Introduction

1.1 This Policy Statement is issued under Section 3(2)(a) of the Insurance Act 1998 as part of the Reserve Bank of Fiji's standards governing the conduct of business of the Fiji National Provident Fund (hereinafter referred to as the "Fund").

1.2 This Policy Statement outlines the Reserve Bank of Fiji's minimum requirements for the management of assets of the Fund. The objective of this Policy Statement is to ensure that the Fund's assets are managed in a sound and prudent manner and available to pay members' benefits when they fall due.

2.0 Background and Outline of the Approach

2.1 The Reserve Bank will not take the approach of imposing quantitative limits on the investments carried out by the Fund. The establishment of prudent limits in the Fund's investment policy and any other policies that pertain to the investment of the Fund's assets will be the responsibility of the Board of Trustees (the Board). The Board and their representatives are subject to a standard of fiduciary responsibility and must invest the Fund's assets in the best interest of the Fund members.

2.2 For assets to be managed effectively, the Fund must take account of its liability profile and the risks that it faces. The assets underpin the ability of the entity to meet its financial obligations as they fall due and must therefore be aligned to the underlying liabilities.

2.3 The Board is required to delegate the operation of the Fund's investment function to fit and proper[1] individuals. The Reserve Bank does not prescribe precise allocations of responsibility, but ultimate accountability remains with the Board. It would be acceptable for most of the functions below to be delegated to the Board Investment Sub-committee, as long as it is appropriately resourced and reported at every Board Meeting.

3.0 Investment Objectives and Investment Strategy

3.1 Investment Objectives

3.1.1 The Board must formulate the Fund's investment objectives, and impose such limitations as it believes necessary to ensure an appropriate balance between risk and return.

3.1.2 The investment objectives for the Fund must:

i. specify the desired investment outcome for the Fund;
ii. be capable of being clearly communicated so that the members can understand the investment approach of the Fund; and

[1] Fit and proper requirements are stated in PS1: Pension Fund Governance Policy for the FNPF.

iii. be such that the extent to which the investment objective has been met can be easily determined, that is, measurable.

3.1.3 The Board must approve and have written record of the Fund's investment objectives.

3.1.4 There must be procedures and criteria by which the Board periodically reviews the effectiveness of the Fund's investment objectives to determine whether there is a need to change them.

3.2 Board Determinations Relating to Investment Strategies

3.2.1 For the purpose of formulating an investment strategy, the Board must determine:
- i. the level of risk, and the level of volatility of returns, that it considers the members are prepared to accept in connection with investments of the Fund; and
- ii. the desired level of liquidity for the Fund.

3.2.2 A determination under paragraph 3.2.1 must be recorded in writing.

3.2.3 In making a determination under paragraph 3.2.1, the Board must have regard to all the circumstances of the Fund.

3.2.4 In making a determination under paragraph 3.2.1 ii, the Board must also take into account:
- i. the amount it considers should be invested in cash or in assets readily convertible to cash;
- ii. the expected timing of investment income and contributions; and
- iii. the actual or contingent expenditure requirements, for example, taxation or payment of member entitlements.

3.3 Investment Strategies

3.3.1 An investment strategy for the Fund must be recorded in writing.

3.3.2 An investment strategy for the Fund must specify each of the following:
- i. performance benchmarks for the returns the Board is seeking to achieve;
- ii. Board determinations relating to the investment strategies;
- iii. the diversification to be maintained within the asset classes and between asset classes;
- iv. if there are to be restrictions or prohibitions on investing in assets of a particular category – what those restrictions and prohibitions are;
- v. any restrictions on the Fund holding investments in a single entity or group of companies;
- vi. any minimum liquidity standards for particular categories of investments;
- vii. factors that are peculiar to the Fund; and
- viii. the use of derivatives or hedges.

3.3.3 In formulating and reviewing an investment strategy for the Fund, the Board must take into account the following:

i. the membership profile of the Fund;
ii. the reasonable expectations of members;
iii. the nature and expected timing of members' entitlements;
iv. the size of the Fund;
v. limitations and constraints on investments;
vi. any report from experts or other qualified professionals;
vii. any actual or potential conflicts of interest involving the Board or an associate of the Board.

3.3.4 The investments of the Fund must be consistent with the Fund's investment strategy.

3.3.5 An investment strategy for the Fund must be clearly expressed so that members and prospective members can easily understand it and can assess the investment performance and management of the Fund.

3.3.6 There must be procedures and criteria by which the Board periodically reviews the effectiveness of the Fund's investment strategies to determine whether there is a need to change them.

3.4 Target Range and Benchmarks

3.4.1 The Fund's Investment Policy Statement must state the target range for the proportion of assets to be held in each asset class and in local and foreign currencies, after having considered the risks[2] for each asset class.

3.4.2 The Fund must set a benchmark against which investment performance for the Fund will be measured as a whole and for each asset class.

3.4.3 The Fund's Investment Policy Statement must also state how the Board determined the target ranges and the benchmarks and all the necessary factors that were taken into account in the determination.

3.4.4 The Board must ensure that there is appropriate diversification of the Fund's assets within each asset class.

3.4.5 The Fund must develop policies outlining its:

i. maximum exposure per investment; and
ii. exit strategy and stop loss strategy.

3.5 Appropriate Skills

3.5.1 The Fund must not enter into investment contracts for instruments it is unable to evaluate expertly and independently through approved due diligence proceedings. Such evaluation includes the expected return, the risks and all charges that are likely to be incurred.

[2] Risks such as market risk, credit risk, liquidity risk, strategic risk, and political risk.

4.0 Due Diligence Process

4.1 When assessing investment proposals, the Fund must consider the following thirteen factors [these factors are listed under section 7 of the *Fiji National Provident Fund (Amendment) Act 2005*]:

i. the purposes of the Fund and the needs and circumstances of the members of the Fund;
ii. the desirability of diversifying the investments of the Fund;
iii. the nature of existing Fund investments;
iv. the need to maintain the real value of the capital or income of the Fund;
v. the risk of loss or depreciation of capital or income;
vi. the potential for capital appreciation;
vii. the likely income return and the timing of the income return;
viii. the length of the term of the proposed investment;
ix. the liquidity and marketability of the proposed investment during, and on the determination of, the term of the proposed investment;
x. the aggregate value of the Fund;
xi. the likelihood of inflation affecting the value of the proposed investment or other Fund investments;
xii. costs in respect of making proposed investments including commissions, fees, charges and duties; and
xiii. the outcome of a review of existing Fund investments.

4.2 The Fund must develop a due diligence and risk assessment process to be used when deciding on its investments. This process must be recorded in writing and must be approved by the Board.

5.0 Monitoring

5.1 Valuation of Fund Assets

5.1.1 Fund assets are to be valued on a basis that is adequate for accounting and reporting purposes. Compliance with FAS 39: Financial Instruments: Recognition and Measurement is required when valuing investments.

5.1.2 For purposes of investment performance measurement, all assets must be valued at market or fair value at least quarterly. In the event that the Fund wishes to use any other method for the valuation of its assets, the Fund must first seek written approval from the Fiji Institute of Accountants and must provide the Reserve Bank of Fiji with written notification of this approval, no later than 30 calendar days from the date of approval. Independent confirmation of the methodology and assumptions used for the quarterly estimates must be made at least every two years.

5.2 Reporting of Net Investment Returns

5.2.1 The investment returns for each class of asset must be reported to the Board at least quarterly.

5.2.2 The Board must stipulate all that is necessary to be submitted to them to enable them to make the right decision.

5.2.3 The returns for each class of assets must be compared with the relevant benchmark. An attribution analysis must show the relevant contribution of asset allocation to the Fund's investment performance.

5.2.4 The reports must include the cost of all relevant expenses, including payments to stockbrokers and other service providers, whether such payments are made directly or by other service providers.

6.0 Operations

6.1 Outsourcing

6.1.1 The Fund may use the services of suitably qualified investment consultants for investment strategy design, research and implementation, however, the Fund must retain full control of the outsourced activity.

6.1.2 The Fund is advised to use independent custodians for the safekeeping of assets, and may also use them for other services such as clearing, settlement, investment administration and reporting.

6.1.3 Where the Board outsources a function, it must ensure proper selection processes and its due diligence examinations are adhered to and are documented. The appointment must be in writing and must clearly specify the functions to be outsourced and address issues such as:

i. functions that may not be sub-contracted;
ii. performance standards and benchmarks;
iii. regular reporting processes;
iv. fees and charges;
v. termination clauses;
vi. ownership of books and records; and
vii. dispute resolution procedures and indemnification conditions.

6.1.4 The Board must ensure that the appointment enables them to seek information from the service provider at any time.

6.1.5 The service provider must be a body corporate and must not be a disqualified person. Broadly, a body corporate may be disqualified as a result of insolvency, being wound up or where the body corporate knows or has reasonable grounds to suspect that a disqualified person is acting as a director, secretary or an executive officer of the body corporate that is involved in this outsourcing arrangement.

7.0 Conflicts of Interest

7.1 A conflict of interest arises where a responsible person influences the Fund's decisions in ways that could result in their personal gain, benefit or advantage of any kind. Examples of conflicts of interest include, but are not limited to, situations where Fund member interests are neglected or made secondary to the interests of a responsible person, as a result of:

i. the allocation of the Fund's assets;
ii. the terms and conditions of related party transactions that are not made on an arm's length basis; or
iii. any other instances that may be determined by the Reserve Bank of Fiji.

7.2 A responsible person must disclose, in writing, to the Chair of the Board or his/her proxy, all his/her business and other interests. These disclosures are to be renewed within 30 calendar days of the commencement of the Fund's financial year. A subsequent change in an interest of a responsible person must be disclosed immediately.

7.3 The Board must identify all conflicts of interest of a responsible person, where the responsible person may be a director, officer, or shareholder of, or may have a relationship with, an entity that the Fund intends to do business with.

7.4 The Board must make certain that there are procedures in place to ensure that those involved with implementing the investment strategies understand where conflicts of interest could arise and how they must be addressed.

7.5 Members of the Investment Sub-Committee and the Board must leave meetings for the duration of a discussion where they may have a conflict of interest. They may not indicate their views on the merits of the investment, nor return until a decision is made.

7.6 The Fund must establish policies and procedures on related party transactions. These must include limits applied, terms of transactions and the authorities and procedures for approving and monitoring these transactions. Disclosure of related party transactions must be in accordance with FAS 24 Related Party Disclosures.

8.0 Communication

8.1 Achievement of the Fund's objectives requires communication and cooperation between the parties involved in setting and carrying out the investment policy. Therefore, copies of the investment policy must be sent to custodians, investment managers, investment consultants, internal and external auditors and any appointed actuary, if requested by these parties. The parties must treat this information as strictly confidential.

8.2 The Fund must provide members with investment information at least annually. This investment information includes, but is not limited to the Fund's:

i. investment policy; and
ii. investment performance.

9.0 Reporting to the Reserve Bank of Fiji

9.1 For the purpose of this Policy Statement, the Fund is required to provide the Reserve Bank of Fiji with copies of the following (*for information*):

i. the Fund's Investment Policy Statement containing the Fund's investment objectives and investment strategies;
ii. the Fund's due diligence and risk assessment process that is to be used when deciding on its investments;
iii. an attribution analysis of the Fund's performance over the past year;
iv. detailed copies of the Fund's 100% owned subsidiaries' asset allocation strategy, for their investment portfolio, including the:
    a) local and offshore equities portfolio;
    b) offshore term deposits; and
    c) summary of fixed interest securities;
v. copies of the Fund's outsourced activity agreements; and
vi. details on appointment of professional investment consultants, custodians and investment managers (That is, their CVs, evidence of experience in performing the required tasks, justification for selection and all expenses that the Fund is required to pay for receiving their services).

9.2 For the purpose of paragraph 9.1, reports on changes to (i) – (vi) above must also be provided to the Reserve Bank of Fiji, no later than 30 calendar days from the date of Board approval.

10.0 Implementation Arrangements

10.1 Compliance

The Reserve Bank of Fiji will assess the Fund's compliance with the requirements of this Policy Statement through its off-site and on-site examinations of the Fund. Non-compliance with the requirements of this Policy Statement will result in the application of the general penalty and enforcement provisions of Section 168 of the Insurance Act 1998.

10.2 Effective Date

The Policy Statement applies to the Fiji National Provident Fund and becomes effective from 01 July 2007.

Reserve Bank of Fiji

June 2007

SCHEDULE

Interpretation-

(1) Any term or expression used in this Policy Statement that is not defined in this Policy Statement:

(a) which is defined in the Act, shall, unless the context otherwise requires, have the meaning given to it by the Act;

(b) which is not defined in the Act and which is defined in any of the Reserve Bank of Fiji Policy Statements shall, unless the context otherwise requires, have the meaning given to it by those policy statements; and

(c) which is not defined in the Act or in any of the Reserve Bank of Fiji Policy Statements shall, unless the context otherwise requires, be interpreted in accordance with generally accepted accounting practice.

(2) In this Policy Statement, unless the context otherwise requires:

'Arm's length basis' means on a commercial basis.

'Associate' means a party or individual having any financial dealings with the Board.

'Board' refers to the Fiji National Provident Fund Board of Trustees.

'Entity' refers to a corporation, government or governmental subdivision or agency, business trust, estate, trust, an individual (sole trader), partnership or association, a body corporate, a corporation, an incorporated association or body of persons, a trust or superannuation fund.

'Exit strategy' means the method by which the Fund intends to get out of an investment that it has made in the past. In other words, the exit strategy is a way of "cashing out" an investment. Examples include an initial public offering (IPO) or being bought out by a larger player in the industry.

'Group of companies' refers to a corporate entity where one company controls one or several other companies or subsidiaries by holding at least a 50% stake in the respective companies.

'Related party' refers to a person/entity that has the ability to control another person/entity or to exercise significant influence over the other person/entity in making financial and/or operating decisions.

'Responsible person' refers to a member of the Board, its subcommittees, senior management or any other person whose conduct is most likely to have significant impact on the Fund's sound and prudent management.

'Significant influence' refers to the ability to participate in the financial and operating policy decisions of a person/entity.

'Stop loss strategy' refers to the method by which the Fund intends to sell a financial instrument when it has reached a specified level, in order to prevent further losses. The strategy would include the timing of the sale, that is, when to sell the instrument and at what price in order to minimise the loss.

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