

Derivatives Risk Statement 2010

AMP Capital Investors Limited (ABN 59 001 777 591)



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AMP CAPITAL INVESTORS LIMITED - DERIVATIVES RISK STATEMENT

1. Responsible Party - AMP Capital Investors Limited

AMP Capital Investors Limited (AMPCI), as investment manager, has prepared this Derivatives Risk Statement (DRS) in accordance with the Australian Prudential Regulation Authority (APRA) Superannuation Circular No II.D.7 (Circular) dated 17 February 1997 and the Derivatives Addendum dated October 1998. Although the Circular was superseded by APRA Prudential Practice Guide 200 – Risk Management in August 2010 and only applies to Registrable Superannuation Entities (RSE), as an investment manager, AMPCI has decided to continue to prepare its DRS in accordance with the Circular.

2. Objective of the DRS

The objective of this DRS is to provide a brief description of the:

- policies that are in place for the use and control of derivatives; and
- processes and procedures that are in place for assessing compliance with those controls.

The policies and procedures described in the DRS form part of the overall investment operations in place at AMPCI that are designed to achieve the investment strategy being implemented for each fund or portfolio.

The DRS is reviewed and updated where necessary on an annual basis and approved by the AMPCI Board of Directors. The DRS is communicated internally to all persons who are responsible for managing, monitoring or implementing the investment processes of AMPCI.

3. Definition of derivatives

Derivatives have been defined by APRA as “a financial contract whose value depends on, or is derived from assets, liabilities or indices (the “underlying asset”).”

This definition includes futures, options, swaps, forwards, warrants and other related instruments. Derivatives do not include underwriting or sub-underwriting activity, partly paid shares or company issued options (where they arise incidentally to other investment activity and will not have a substantial impact upon the portfolio). However, AMPCI will manage these activities in accordance with the concepts of this DRS, to ensure that funds or portfolios do not accept inappropriate risk through the use of these tools.

4. Relationship to the investment strategy

The use of derivatives is subordinate to the investment strategy and has to be consistent with the investment objective of the fund or portfolio. Derivatives will only be used within the strategy of the fund or portfolio. Derivatives will not be used where their use will result in conflict with the strategy, objectives or constraints of a fund or portfolio. The overall investment strategy is defined and governed by:

- The relevant Investment Management Agreement (IMA), Investment Mandates (IM), Management Agreements (MA) or equivalent document established between the relevant client and AMPCI; and/or
- The relevant offer documentation including Information Memorandum (IME) and Product Disclosure Statements (PDS) that are provided to potential investors;

collectively known as “IMA or equivalent”.

Unless specified otherwise in the investment strategy, AMPCI will not use derivatives to obtain exposure that is substantially different from that which could be obtained through physical securities.

The investment strategy and any limits and controls specified in the IMA, IM, IME, MA, PDS or equivalent documents specified above established between the relevant client and AMPCI will take precedence over the use of derivatives and the controls surrounding its use described in this DRS.

Risk Tolerances

The risk profile of each fund and portfolio is set out in the IMA or equivalent that is established for each fund and portfolio.

5. Purpose of using derivatives

The use of derivatives is considered an essential part of the prudent management of assets by AMPCI, with the prime objective being to enhance the total performance (including but not limited to return) of a particular fund and/or portfolio.

Derivatives can be used for a variety of purposes. AMPCI permits the use of derivatives based on the following guiding principles:

- their use is within the strategy, objectives and constraints set by the client;
- gearing of fund or portfolio if it is required as part of the investment strategy;
- there is always adequate underlying asset cover to meet any obligations arising from the use of derivatives;
- proper consideration is given to liquidity management having regard to the particular portfolio strategy; and
- derivatives are executed by staff that are qualified, knowledgeable and trained in the use of derivatives.

However, as noted, the use of derivatives must comply with the investment strategy, and where the investment strategy specifically states that derivatives may be used in other ways, e.g. to leverage returns, the specifics of that strategy will apply.

Derivative usage may include the following circumstances:

(a) Hedging

Hedging to protect an asset or portfolio or fund against a fluctuation in market value, or to reduce the impact of such a fluctuation, including foreign exchange hedging.

(b) Transaction efficiency and cost

In achieving the objective of the investment strategy, AMPCI may find it effective to execute derivative transactions to achieve transactional efficiency through reduced transaction cost and/or obtaining prices that are better than the available in the physical or cash market.

(c) Investment tactical reasons

In achieving the overall objectives of the investment strategy, AMPCI may execute derivative transactions due to investment tactical reasons. These reasons may include:

- reduction of volatility;
- controlling the impact of significant transactions on portfolio valuations;
- adjusting the yield curve;
- taking advantage of market imperfections;

- adjusting duration of fixed interest portfolios;
- adjusting asset exposure within established strategy; and
- managing credit risk.

If the Investment Manager/team proposes the use of a new derivative instrument or an existing instrument in a new market, such use would require approval by the relevant Chief Investment Officer (CIO) or by a committee or individual(s) delegated by the relevant CIO. Approval considerations include the guiding principles specified in this DRS and the specific strategies or purpose of the particular portfolio involved.

In addition, the following operational aspects are considered while setting limits to derivative usage (See “specific limits” in section 6 below):

- ease or difficulty of measurement of potential derivative exposure;
- ease or difficulty in closing derivative position;
- market liquidity of the derivative; and
- counterparties to the derivative transaction.

6. Restrictions on the use of derivatives

Derivative exposure combined with physical exposure should not result in a net exposure which is inconsistent with any fund’s investment strategy.

Derivatives will not be used for speculation. Speculation means one of the following:

- the net exposure of the fund to an asset class exceeds the limits set out in the fund’s investment strategy;
- the fund or portfolio is outside the risk limits specified by the investment strategy;
- the fund holding uncovered derivatives outside the risk limits specified by the investment strategy; or
- in case of funds governed by the Superannuation Industry Supervision (SIS) Act of 1993, the fund’s total portfolio being ‘geared up’ through derivatives in violation of limitations imposed by sections 67, 95 and 97 of the SIS Act on borrowings.

Deviations from the above restrictions may arise in the derivative positions held by AMPCI as a result of unforeseen market movements, investor contribution or withdrawal, or variation of investment parameters. These deviations will be reported to management by the Mandate Compliance and Investment Management teams who will take measures to rectify the position as soon as possible.

The Risk & Compliance team is responsible for monitoring adherence to relevant Financial Services Legislation, Regulations, Regulatory Policy and Circulars. The contractual obligations with clients are also reflected in the mandate rules and constraints, which are monitored by the Mandate Compliance Team.

Specific Limits

Fixed income and cash portfolios

Fixed income and cash portfolio’s interest rate risk is managed by way of reference to the duration of the portfolio. All positions, including derivative positions, must be managed in accordance with the duration requirements set out in the IMA or equivalent. In the absence of any specified duration band, the relevant index plus or minus 1.5 years will be generally applicable.

Operating instructions will be issued as appropriate from time to time by the CIO.

The “gearing and cover requirements” 2 and 5 specified in section 7 do not apply to fixed interest or cash portfolios.

Foreign exchange portfolios

Specific limits relevant to foreign exchange transactions are set out in Section 8. Section 7 does not apply in relation to foreign exchange positions.

All other portfolios

Unless specifically authorised by an IMA or equivalent, gross derivatives exposure (i.e. no netting of sold and bought positions) must not represent more than 50% of a particular portfolio or fund. In all cases any specific limits required by a client will override these general limits. Such client limits should be clearly set out in the IMA or equivalent.

In determining exposure, it is recognised that certain exposures may be obtained by way of a series of contracts (e.g. a three month futures contract each quarter to give effectively a one year exposure). This is considered to be a single exposure, as opposed to four separate exposures. It is expected AMPCI will exercise its professional judgement to determine effective exposure in such cases.

7. Risk Analysis

As in any investment decision, the use of derivatives results in various inherent risks. AMPCI has processes in place to identify, assess, remedy, monitor and manage these risks. These processes form part of the overall operation and risk management structures at AMPCI. The organisational and operational structure is also designed to ensure separation of dealing, administration and management of derivatives. This includes:

- a third party custodian and investment administrator who is independent of AMPCI, except for property assets; and
- an Investment Control team that is separate from the Investment Management teams. This team is responsible for performing mandate compliance and investment analytic functions, including performance attribution checks.

The major risks associated with the use of derivatives and the relevant controls AMPCI has in place to ensure that these risks are within the relevant risk tolerance established for each fund and portfolio, are set out in the following paragraphs.

a) Market Risk

Market risk is one of the key risks that impact the use of derivatives.

Market risk represents the risk of adverse movements in markets (including asset prices, volatility, changes in yield curve, implied option volatility or other market variables) for the derivative or underlying asset, reference rate or index to which the derivative relates. In particular, derivatives give rise to the risk that the derivative(s) used may not move identically to the underlying asset(s) value (basis risk).

Exposure to options or option related derivatives is calculated on a delta weighted basis.

The control of market risk primarily involves the use of investment strategy that includes establishment of strategic ranges for each fund and portfolio, which control the exposure to any asset class.

AMPCI manages market risks through controls in the areas of gearing and cover requirements, exposures to asset ranges, and stress testing. Some of these are described in more detail below.

Gearing and Cover requirements

1. In the case of derivative positions that are held to achieve exposure, cover consists of assets that in AMPCIs professional judgement are equivalent to cash and can be converted to cash within the settlement period. The assets must be sufficient to meet all potential obligations arising from the underlying asset exposure represented by the derivative position. Synthetic cash, created by selling derivatives, may be used as part of cover. Net derivative positions may be considered where appropriate.
2. In the case of bought call option positions, no cover is required if the delta adjusted value of such options is less than 10% of the portfolio, as there is no obligation to exercise the option. Positions in excess of 10% of the portfolio require appropriate cover at the delta adjusted value (except for fixed interest or cash portfolios).
3. Partly paid shares are not considered derivatives but nevertheless there is a potential obligation and investment managers are expected to ensure there is appropriate cover dependent upon the exact terms and the period until payment.
4. With company issued options, as there is no obligation to exercise these and as they are often issued for no consideration, cover is not normally required. However, it is expected that if they exceed 10% of the portfolio, appropriate cover will be provided.
5. In certain circumstances, AMPCI may use sold put options to acquire exposures. Where these are in readily tradeable securities and do not amount to more than 5% of the portfolio in total, cover will be calculated on a delta adjusted basis within a particular portfolio. In other cases, cover will be calculated with a delta of 1 (except for fixed interest or cash portfolios).
6. Internal cash overdrafts (i.e. where there is "borrowing" within certain portfolios of the same fund) may exist provided they are covered by synthetic cash. For separately managed portfolios, these are a maximum of 5% of the fund or portfolio unless otherwise set out in the relevant IMA or equivalent.
7. Fixed interest portfolios and cash portfolios are managed generally by way of reference to the "duration" of the portfolio. In considering whether positions are covered, operating instructions will be issued as appropriate from time to time by the CIO.
8. In case of doubt in respect of determination of appropriate cover, the Investment Team Leaders will make the determination.

Exposure Management

9. In using derivatives, the exposure created is considered on the basis of a delta weighted effective exposure, after incorporating all derivatives. Net exposure is restricted within the strategic ranges or limits set out in the IMA or equivalent.
10. Unless set out in the IMA or equivalent or specifically agreed by the client, in the case of derivative positions acquired to remove exposure, cover consists of assets which, in AMPCI professional judgement, are considered a reasonable hedge. Net derivative positions can be considered where appropriate.
11. Short positions may arise if more of an asset is sold, using derivatives, than is physically owned. Short positions may be acquired in terms of point 10 above, if it is considered a reasonable hedge, or within sub portfolios of an overall portfolio where the total position is not short, or if it is allowed in the specific strategy of that portfolio or fund.

Stress Testing

12. Regular stress testing is undertaken to determine the impact of adverse market moves on the value of portfolios and the impact of any derivative positions. Such testing is undertaken to determine if the resultant structure of the fund or portfolio results in gearing. Unless set out in the IMA or equivalent or specifically agreed by the client, positions that result in gearing as a result of this testing are reviewed by senior management.
13. The monitoring, reporting and stress testing is carried out by personnel who are independent of the investment management function.

b) Liquidity Risk

Liquidity risk exists in two forms:

- a) the risk that a particular position cannot be unwound;
- b) the risk that the fund or portfolio will not be able to meet its obligations resulting from its derivatives activities.

AMPCI gives consideration to liquidity of the portfolio as part of its investment strategy decisions. These considerations include derivative transactions. AMPCI's consideration to derivative liquidity risk also includes the following controls:

1. All new types of derivative instruments need to be analysed and approved by the CIO or a CIO delegated committee or person. The analysis includes assessing the market depth of the instrument to be traded.
2. Derivative exposures are monitored by the Investment Management teams as part of the portfolio management process in accordance with investment mandates. All derivative trading will be subject to appropriate levels of overview by the senior Investment Managers.
3. A periodic (daily, weekly and/or monthly depending on the fund) portfolio liquidity report that includes exposures to derivative transactions is used by Investment Managers to ensure that liquidity of the portfolio is adequately considered. This is also monitored to ensure that cover requirements for use of derivatives are satisfied.

c) Counterparty (Credit) Risk

Counterparty risk refers to the risk that the other party to the derivative transaction may not honour their contractual obligations.

Management of counterparty risk at AMPCI includes the implementation of the following controls:

1. Each client of AMPCI may establish their risk tolerance to credit risk, as set out in the IMA or equivalent. AMPCI monitors adherence to the set risk tolerance through mandate constraints that are considered as part of investment decisions.
2. The Mandate Compliance Team independently monitors adherence with credit constraints as set out in the IMA or equivalent.
3. Derivative transactions for exchange traded derivatives are only conducted through recognised exchanges. AMPCI periodically assesses the credit risk of the major 'clearers' it uses to facilitate these transactions.
4. In respect of 'over the counter' derivatives, AMPCI ensures that there are appropriate agreements in place with each counterparty (e.g. an International Swaps and Derivatives Association recommended agreement). Appropriateness is considered based on financial strength and reputation of the counterparty, having regard to the nature of the IMA or equivalent.

5. The AMPCI Legal team is responsible for reviewing the adequacy of legal agreements with respect to derivatives and that counterparties are able to legally enter such transactions.
6. Documentation such as transaction agreements and settlement details are securely held independent of the Investment Management teams.

d) Operational Risk

According to Basel II international standard, operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

In the use of derivatives, operational risks assume significance because of the complex nature of their payment structures and calculation of their values. AMPCI values derivatives based on current industry standards. Valuation is based on independent sources of data, including counterparty confirmations.

A key control at AMPCI is the separation of duties to ensure that there is independence in monitoring and reporting on the use of derivatives, so as to reduce the potential for errors or fraud, and allows adequate cross checking and verification.

Management of operational risk at AMPCI includes the implementation of the following controls:

People & Responsibilities

1. Compliance monitoring and other custodial responsibilities (including settlement) are performed and managed independently of those persons charged with managing funds. These functions have independent lines of reporting, including to the Board (or its delegated sub Committee), as appropriate.
2. Separation of duties within AMPCI is exercised at several levels and there are clearly nominated officers within each team responsible for each activity:
 - AMPCI has established delegations of authority limits for various levels of management with respect to deal origination;
 - IMAs or equivalent prescribing overall risk and exposure are set by the particular client concerned and agreed through the Client Services Manager;
 - The Mandate Compliance team independently monitors adherence with the IMAs or equivalent and reports to Senior Management, including Client Services and Product Technical teams;
 - The Investment Analytics team is responsible for investment attribution checks; and
 - The AMPCI Risk & Compliance team oversees the management of operational risk and regulatory compliance.
3. Investment Management and the Product Technical teams are accountable to ensure that prudent portfolio/fund investment profiles exist and that they comply with all Constitution / Trust Deed and contractual requirements.
4. The Client Service Manager and the Investment Manager facilitate the agreement of the portfolio risk profile with the clients.
5. The Investment Manager is accountable for the day to day risk management of their portfolios. They are required to manage those portfolios in accordance with IMA or equivalent and the AMPCI operating procedures. They are required to monitor any breaches and take appropriate remedial action as soon as possible.
6. The accounting and settlement functions are segregated from the investment and dealing functions. The records of derivative trades are independently reconciled to the records of the counterparty.

Processes

1. Controls are in place to confirm that all funds and portfolios remain within their portfolio profiles, whilst delivering results consistent with stated objectives in the investment strategy. This occurs through regular monitoring and reporting with:
 - Investment Managers being responsible for the day to day management and adherence to IMAs or equivalent;
 - Mandate Compliance team and Investment Analytics team are responsible for monitoring and reporting to the Senior Management;
 - Incident Working Group, comprising senior business managers from a number of teams, is responsible for reviewing exceptions reported; and
 - Client Services managers/team are responsible for communicating mandate related information between the client and the relevant teams within AMPCI.
2. All portfolio management activities are performed in accordance with a formally documented set of delegation of authorities approved by the AMP Limited Board.
3. Transactions are evidenced with relevant documentation in accordance with market practices before recording of these in AMPCI transaction recording and reporting system.
4. All derivative legal agreements, including custodial agreements, are reviewed by the AMPCI Legal team.
5. The Client Services team provides clients with information on their investments, including on the use of derivatives.
6. Portfolios are regularly marked to market on both a market value and a delta adjusted exposure basis, based on independently sourced data and according to AMPCI Valuation policy and procedures. Any departure from this due to a lack of independent data is noted. The AMPCI Risk & Compliance team is required to assess the risks in such a situation and agree on suitable alternate compensating controls.
7. A review of the Mandate (requirements of the IMA or equivalent) with the Mandate Compliance system is performed periodically by the Mandate Compliance team with a view of reviewing all mandates over a two year period.
8. The relevant CIO and the delegated sector managers are responsible for ensuring that Investment Manager/team operate within these constraints and oversee any remedial action required in the event of a breach.
9. All counterparties are requested to provide deal confirmations and settlement details to AMPCI's investment administrator, BNP Paribas Fund Services Australasia Pty Limited ('BNPP') Derivatives Operations Team (or equivalent). BNPP is independent of AMPCI, further enhancing separation of duties.

Systems

1. All derivative transactions are recorded in AMPCI systems and are regularly audited by internal and external auditors to ensure controls are in place to provide comfort over integrity of the information generated through the computer systems.
2. Before approval is granted for trading in new derivative instruments, the relevant CIO or delegate is required to assess the adequacy of the supporting operating systems.
3. Procedures are in place to ensure that all transactions are recorded in the transaction processing systems of AMPCI as soon as the deal has been confirmed to enable continued monitoring of derivatives in accordance with this DRS.

e) Property Business

This DRS equally applies to the Property business of AMPCI ("Property"), except for specific variations in respect of Section 7 and 8, where due to the nature of property investments, the nature of controls is as stated below.

The property business uses derivatives as an essential part of the management of assets managed by them, with the prime objective being to enhance the total performance (including but not limited to return) of a particular fund and/or portfolio. In no way will the use of derivatives compromise the strategy, objectives or constraints of a fund or portfolio.

In respect of Risk Analysis and Currency (Sections 7a-d and 8), Property performs activities according to its risk management policies and procedures. These documents include guidelines and controls that must be followed in respect of interest rate risk management, measurement methodology, risk parameters, operational controls, reporting and foreign exchange risk management.

Key controls that Property follows as part of the policies and procedures are:

1. Segregation of duties is maintained in respect for functions of deal origination, deal confirmation and settlement. Property Investment Managers are responsible for deal origination and decisions making, while Finance and Investment Services (FIS) staff are responsible for deal confirmation, settlement and recording. Property Investment Managers and FIS have different management reporting lines within AMPCI.
2. The impact of interest rate exposure upon profitability of the property trusts is measured over a 10 year forecast period. Interest rate hedging is undertaken and takes in to account current debt levels and contracted capital expenditure. Each fund may not hedge more than 100% and not less than 40% of forecast underlying interest rate exposure in any reporting period within a 10 year forecast horizon subject to the following earnings sensitivity measure: Each of the funds should have sufficient foreign exchange and/or interest rate hedges in place to ensure that 1 year forecast distributable income varies by no more than 3% with a 95% degree of confidence.
3. Risk parameters and limits are set for each trust and adherence to these is monitored every six months. Earnings at Risk (EaR) is set according to minimum acceptable risk threshold for each trust.
4. Foreign exchange hedging is undertaken in respect of forecast foreign exchange currency income net of foreign currency expenses and contracted capital expenditure (Translation Risk).
5. Foreign exchange hedging is undertaken in respect of the currency the fund is denominated in or the native currency value of foreign currency assets, subject to Value at Risk (VaR) limit. Each fund may not hedge more than 100% and not less than 50% of forecast foreign currency income (based on lease income and contracted capital expenditure) over a 10 year forecast horizon.
6. Measurement of acceptable risk to fund net asset value, net income and cash flow is made with reference to the effect of financial market movements on the net tangible assets, revenue and expenditure and cash flows of the fund on a prospective basis at the time of transaction origination and reporting. This ensures that no individual investment, interest rate or currency exposure is considered in isolation. In determining appropriate hedging in respect of the investment, interest or currency exposure, the management considers amongst other things, the volatility of the interest rate and currencies involved, the volatility of the cash flows generated by the investment, the cost of hedging, and the size of the risk in the context of the total fund size.
7. All derivative transactions are recorded in AMPCI's systems, which are managed and controlled according to AMP IT security guidelines to maintain integrity of the information generated through the computer systems. Before approval is granted for trading in new derivative instruments, the relevant CIO or delegate is required to assess the adequacy of the supporting computer systems.

8. Currency

Foreign currency exposure will naturally arise from investment in overseas assets. As part of normal portfolio risk management, currency hedging may be used by AMPCI. Currency profiles are established to ensure there is a clear understanding of the objectives, authorities and controls on such activity.

It is acknowledged that hedging activity will primarily be by way of forward contracts, but options and other derivatives may also be used. In all cases, the guiding principles specified in this DRS are considered. However, “cover” may not be in strict accordance with the definitions in section 7a - Market Risk, as by definition the assets backing the foreign currency may be in shares, property etc, as opposed to “cash or cash equivalent”, while the backing for the Australian Dollar (AUD or base currency) hedge will be the foreign currency.

In addition, the use of different currencies within blocs, or the hedging of a basket of currencies back to AUD (or base currency), as opposed to exact currency mixes, means that negative currency positions may arise (i.e. over hedging).

Management of currency risk at AMPCI includes the implementation of the following controls:

1. The overriding principle in all cases is that there should be no gearing - the total net currency position of the portfolio must not exceed the market value of the assets - and any activity must be within the IMA or equivalent.
2. Negative currency positions that may arise are monitored and AMPCI will use its professional judgement to ensure that resultant structure is appropriate.
3. AMPCI monitors the effectiveness of all foreign exchange hedging in relation to the investment strategy.
4. AMPCI reports appropriately on all foreign exchange hedging positions.
5. For Property Business, please refer to section 7e – Risk Analysis – Property Business above.

9. Personnel Management

AMPCI recognises that due to the complexity and risk involved in dealing with derivatives, sufficient skills and knowledge are required to transact in derivative instruments.

AMPCI ensures that staff with appropriate skills and professional expertise are responsible for managing portfolios that include the use of derivatives. Personnel are also required to participate in ongoing training and knowledge update programs and briefings. This statement is also made available to all AMPCI staff.

Management of personnel risk at AMPCI includes the implementation of the following controls, along with people controls described under operational risk:

1. Staff expertise is considered by the relevant CIO or by a committee or individual delegated by the CIO, before approval is given to trade in new instruments.
2. All personnel responsible for the trading and administrative support of derivative securities are required to have appropriate educational qualifications and practical experience. These personnel will complete ongoing derivatives training, which may cover topics such as new instruments and the law pertaining to trading and market practices, as appropriate.
3. The remuneration system for AMPCI staff is such that while there are performance incentives, this is capped to dissuade excessive risk taking.
4. There is separation of duties and staff reporting lines (refer section 7d - Operational Risk).

10. Assessment of Controls

In addition to the review of the controls and procedures outlined in this DRS as part of the normal management functions of the personnel involved, the following assessments are conducted:

1. The CIO or by a committee or individual delegated by the CIO may request an assessment of derivative controls from time to time based on changes in the business environment, regulatory changes, organisational changes.
2. As determined appropriate from time to time there may be assessments by the Internal Audit function which operates independently of the business.
3. The Mandate Compliance team regularly monitors the adherence to derivative mandates and constraints and provides reports to various management levels.
4. The DRS is annually reviewed and approved by the CIOs and senior management.
5. The DRS is approved by the AMPCI Board annually after considering the compliance of business activity and reporting from the Risk & Compliance team.
6. The AMPCI Audit Committee with majority of non-executive members oversees the maintenance of adequate and an effective internal control environment.
7. The AMPCI Business Risk and Compliance Committee consider mandate breaches and provides oversight over performance of rectification actions.

11. External Audit

The DRS is subject to an annual external audit. The scope of the audit requires the auditors to assess and report on whether the major procedures described in this DRS have been followed and that any changes have been approved. The audit is to be conducted in accordance with Australian Auditing Standards.

12. Reporting

Internal Reporting to Board of Directors - Significant Exposures

AMPCI provides such reports to the Board of Directors of AMP Capital Investors and other Boards in the AMP Limited Group (or their delegated sub committees) to enable them to perform their responsibilities. Reporting with respect to compliance matters is performed with consideration to materiality and the nature of the compliance breach.

Reporting to Clients

AMPCI's Client Services team provides reporting to clients as is agreed in their individual IMA or equivalent and is necessary for the client to fulfil their obligations. This involves supplying a copy of this DRS together with any subsequent changes.

On an ongoing basis, AMPCI provides regular and appropriate reporting on asset exposures including the impact of derivatives, as agreed with the client. The Mandate Compliance team monitors exposure. They inform and provide information to the Client Services team if a significant occurrence requires reporting to the client. AMPCI also reports on matters when, in its professional judgement, there is a significant occurrence or event in relation to the use of derivatives.

It is recognised that daily movements in markets may create compliance breaches which are beyond the control of AMPCI, and which the controls and systems are designed to identify and correct. Provided that such breaches are not material, corrected as soon as practicable and do not represent a fundamental breach in controls, such breaches will not be specifically identified or referred to in any reporting.

13. External Investment Managers

AMPCI may appoint external fund managers as part of its or the clients investment or product strategy. These fund managers may operate outside Australia and may not be subject to Australian regulations relating to preparation and disclosure of derivative risk management statements. AMPCI performs the following control activities to ensure reasonable derivative risk management checks are in place within the operations of these fund managers:

1. All external fund managers, including those domiciled overseas, are appointed after a due diligence process. The due diligence process includes an evaluation of the capabilities of the fund manager and a more specific evaluation of the operational and risk management capabilities. This includes a review of the risk management practices and controls, including their use and control of derivatives.
2. All external fund managers, including those located overseas, are subject to a ongoing monitoring by AMPCI or by an AMPCI appointed external investment consultants, and are formally reviewed on an annual basis or more frequently. A diverse range of 'events' may trigger a periodic review. Such triggers include, but are not limited to, risk issues, a material variation to a manager's business processes or personnel, significant performance issues and mandate breaches.
3. Periodic reports from external fund managers are sought and reviewed as required for assessing the operation of derivative controls. The determination of review intervals is in accordance with AMPCI procedures and is dependant upon the domicile, local regulations and investment management agreement in place with the external fund manager.
4. BNPP monitors and reports compliance and breaches to investment mandates (including derivative guidelines) established with external fund managers. During the setup of mandates with external fund managers, AMPCI considers the guiding principles of this DRS and the overall investment strategy of the fund.

14. Glossary

Asset class exposure	The proportion of an entity's investment portfolio that is invested in a particular asset class (for example, Australian equities or property).
Basis risk	The risk that a derivative position will not move in line with a physical position. For example, a portfolio of Australian equities may not move in line with the Share Price Index (SPI) future which is based on the S&P/ASX 200 Index because of the different weighting of various shares.
CIO (Chief Investment Officer)	AMPCI business broadly consists of Infrastructure, Property, Listed Assets (shares, fixed income and private equity) and Multi-asset Group (multi-manager funds and structured products). Each of these businesses have CIOs within their business. References to CIOs in the DRS refer to the CIO of the relevant business.
Collective investment	A class of investments where investors' subscriptions are typically pooled and managed by an investment manager. Examples would include unit trusts, PSTs, and Life Insurance Company pooled funds.
Counterparty	The other party with whom a derivatives contract is made.
Counterparty risk	The risk that a counterparty will fail to perform contractual obligations (i.e. default) under a contract. This is also sometimes referred to as 'credit risk'.
Cover	<p>In the case of derivative positions to achieve exposure - cover consists of assets that in the responsible party's professional judgment are equivalent to cash and can be converted to cash within the settlement period. They must be sufficient to meet all potential obligations arising from the underlying asset exposure represented by the derivative position. Short dated fixed interest securities may well be equivalent to cash but equities are not. Synthetic cash (e.g. derived by selling 10 year bond futures against the physical bonds) is also acceptable. Net derivative positions can be considered where relevant.</p> <p>In the case of derivative positions to remove exposure - cover consists of assets for which in the responsible party's professional judgment the derivative(s) are considered a reasonable hedge. Net derivative positions can be considered where relevant.</p>
Delta	The expected expansion or contraction in an option premium given a change in the value of the underlying security.
Delta weighted basis	An options position equal to the market value of the underlying security multiplied by the delta.
Derivative exposure	The effective proportion of an entity's investment portfolio that is invested in derivatives. For example, with a futures contract, the exposure is not the amount of margin calls (or deposits) paid but the full value of the contract.
Discretionary individual portfolio	A portfolio over which an investor gives a manager or broker authority to effect transactions without prior reference to or approval from that client.

Exchange traded derivatives	Exchange traded derivatives are only traded on recognised global exchanges (i.e. the Sydney Futures Exchange in Australia). They are typically standardised as to expiry, contract size and delivery terms.
Excluded funds	Are defined in the Superannuation Industry (Supervision) Act 1993 as superannuation funds with fewer than 5 members.
Exotics	Are defined broadly as complex variations of standard derivatives.
Forwards	Are legally binding agreements to buy or sell a commodity, currency or security at a fixed time in the future at a price agreed upon today.
Futures	Are legally binding agreements to buy or sell a commodity or security at a fixed time in the future at a price agreed upon today (i.e. the same as a forward contract). For example, on the Sydney Futures Exchange the delivery period, quantity and quality of a futures contract is standardised and specified, while the price is set at the time the contract is opened and negotiated by competitive outcry between buyers and sellers on the trading floor or on the Exchange's computerised overnight market. At the opening of a position an initial margin or deposit is required (usually less than 5% of the value of the contract). In addition margins are required to be paid (or received) daily reflecting the profit or loss each day.
Gearing	Occurs where the level of market exposure including derivatives exceeds the market value of the fund or portfolio. It can also mean a portfolio is borrowing money in order to increase exposure through the use of derivatives to the underlying asset class beyond its net asset value.
Incident Working Group	The group is responsible for assessing reported incidents on a regular basis and ensuring the incident is investigated and resolved promptly and fairly in accordance with the AMP Group policy.
Investment Management Agreement – Investment Mandate	The schedule or document that records the agreed investment parameters between the client and AMPCI.
Legal risk	The risk that an entity may not have the legal power to enter into a derivatives contract (and is therefore not bound to perform the contractual obligations).
Liquidity risk	An entity faces two types of liquidity risk in its derivatives activities: one related to specific products or markets and the other to the general funding of the entity's derivatives activities. The former is the risk that an entity may not be able to, or cannot easily, unwind or offset a particular position at or near the previous market price because of inadequate market depth or because of disruptions in the market place. The latter is the risk that the entity will not be able to finance its derivatives activities (for example, meeting margin calls on futures contracts).
Margins	'Security' deposits required for exchange traded derivatives to ensure that if the market moves against the derivatives holder during the day, extra backing is provided against potential losses.
Market exposure (exposure)	Market exposure (or exposure) is a financial term which measures the proportion of money invested in the same industry sector.

Marked to market	Recording the price or value of security, portfolio, or account to reflect its current market value
Market risk	The risk to an institution's financial condition resulting from adverse movements in (stock, bond, currency, etc.) market prices.
Net exposure	The total of physical exposure and derivative exposure
Net position	The difference between the open long and open short derivatives positions.
Net short position	The value by which open short derivatives positions exceed the open long derivatives position.
Operational risk	The risk that deficiencies in information systems or internal controls will result in unexpected loss. This risk is associated with human error, system failures and inadequate procedures and controls. This risk can be exacerbated in the case of certain derivatives because of the complex nature of their payment structures and calculation of their values.
Options	Provide investors with the right but not the obligation to buy or sell a commodity, currency, security or futures contract. Buying options provides a means of obtaining insurance against risk in the underlying markets while still providing the investor the option of benefiting from favourable price movements. The fee for this flexibility or 'option' is a premium (likened to a once only insurance premium). Apart from their flexibility, the primary advantage of purchasing options is that they allow investors to take advantage of many different market scenarios and implement strategies whereby any potential losses are limited and are clearly defined at the outset.
Call option	Gives the holder the right but not the obligation to buy a specified commodity, currency, security or futures contract at a designated price on or before a specified date in the future.
Put option	Gives the holder the right but not the obligation to sell a specified commodity, currency, security or futures contract at a designated price, on or before a specified date in the future.
Over-the-counter (OTC) derivatives	Are derivatives not listed on any security exchange. OTC contracts (e.g. between banks and corporations) are custom tailored to an institution's needs and often specify commodities, instruments and/or maturities that are not offered on any exchange. Main OTC derivatives include swaps, forwards and options, which are based upon interest rates, currencies, equities or commodities.
Physical exposure	Is the proportion of an entity's investment portfolio which is invested in 'physical' or actual securities, as distinct from derivative securities. For example, equities would be regarded as physical exposure whereas equity derivatives would be regarded as derivative exposure.

Roles

Client Services Manager/team (or equivalent): responsible for communication with the client in respect of agreed mandates and communicating these mandates internally with the Mandate Compliance and the Fund/Portfolio management teams and the Product technical Manager, as required.

Product Technical Manager/team (or equivalent): responsible for communicating all investment mandates to Mandate Compliance teams. Product Technical team is responsible for communicating AMPCI mandates to external fund managers. Risk & Compliance reviews assurance reports received from external fund managers.

Investment Control Manager/team (or equivalent): encompasses Performance Analytics, Relationship and Service Delivery Management (Administration of Custody and Registry providers), Mandate Compliance and Issue and Error Management teams.

Mandate Compliance Manager/team (or equivalent): responsible for leading the Mandate Compliance team that is responsible for implementing client, product and fund/portfolio driven mandates and constraints, including derivative constraints in the mandate compliance processes and systems. Also, the team is responsible for exception reporting of actual performance against these mandates and constraints to the Client Services managers, Fund/Portfolio Managers and the Risk and Compliance team.

Investment Manager/team (or equivalent): Fund/Portfolio Manager/team responsible for implementing investment strategies agreed between the client and AMPCI and/or product investment strategies. This includes decisions relating to derivative transactions.

Also, the managers are responsible for carrying out pre trade compliance checks and checks on the use of derivatives based on the client agreements and the DRS.

Investment Dealers are responsible for executing the decisions made by the Investment Manager, including executing derivative transactions with the broker / exchange.

Sensitivity analysis

Is the financial modelling technique of determining how changes in selected variables impact on overall results. For example, sensitivity analysis may be used to estimate the impact of falls in the \$A compared to the \$US on a portfolio's investment returns. Stress testing is the related modelling technique which shows the entity's capacity to cope with a series of hypothetical adverse scenarios.

Share ratio futures

Are futures contracts based on the relative movements between the price of a specified share (e.g. BHP) and the All Ordinaries Index.

Swaps	<p>Are agreements between two parties to exchange (swap) their respective obligations (loan repayments or interest payments) so that they can manage their cash flows more effectively. In Australia, there are two main categories of swaps - interest rate swaps and currency swaps. Interest rate swaps are the largest of the two categories and there is no exchange of principal but rather only the stream of periodic interest payments are 'swapped' and settlement is the net difference between the two interest rate costs. Traditionally, interest rate swaps involve an exchange of fixed interest payments for floating rate payments and vice versa.</p>
Synthetic exposure (Synthetic cash)	<p>An arrangement whereby a derivative is aggregated with cash to arrive at an equivalent exposure to the physical situation (for example, combining a ten year bond future with cash, giving equivalent exposure to holding a ten year bond).</p>
Underlying asset	<p>The asset on which the derivative contract is based. For example, a BHP call option is based on BHP shares. The underlying of a derivative is an asset, basket of assets, index, or even another derivative, such that the cash flows of the (former) derivative depend on the value of this underlying.</p>
Valuation risk	<p>The risk that the valuation system incorrectly calculates a price for a derivative or its equivalent exposure.</p>
Warrants	<p>Are the same as call options (see Options) but tend to be long dated.</p>
Yield Curve	<p>The yield curve is the relation between the interest rate (or cost of borrowing) and the time to maturity of the debt for a given borrower in a given currency.</p>