

TOWER Australia Limited

ABN 70 050 109 450

Derivative Risk Management Statement



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Policy Owner: CEO Group Life & Investments

Version Control

Version No.	Date	Details
1.0	May 2007	Prepared for Board approval as part of the Investment Outsourcing Proposal.
2.0	July 2008	Updated to reflect removal of Life Insurance Circular C.I.1 and requirements of LPS220 and LPG250. Also updated roles and responsibilities to ensure alignment with Governance Policies.
3.0	July 2009	Annual review of Policy.
4.0	August 2010	Annual review of Policy. Updated to reflect termination of external managers on ARC product.

PURPOSE

This document sets out TOWER Australia Limited's (TAL) approach in respect of the policies and practices which relate to the use of derivatives in the various TAL Funds. This document forms part of TAL's risk management framework.

This Policy has been designed to comply with Prudential Standard LPS 220 – Risk Management, Prudential Practice Guide LPG 250 - Asset and Liability Management Risk and Life Insurance Regulation 4.00A.

TABLE OF CONTENTS

1.	NAME OF COLLECTIVE INVESTMENT	1
2.	REGULATORY ENVIRONMENT	1
3.	OBJECTIVE OF THIS STATEMENT	1
4.	RISKS OF USING DERIVATIVES	2
5.	INVESTMENT STRATEGY & OBJECTIVES	2
6.	EXPOSURE LIMITS, COMPLIANCE PROCESSES & CONTROLS	2
7.	IDENTIFICATION OF INVESTMENT MANAGER DRS.....	3
8.	ROLES AND RESPONSIBILITIES, QUALIFICATIONS & EXPERIENCE	3
9.	DATE OF AUTHORISATION	4
	SCHEDULE 1	5

1. NAME OF COLLECTIVE INVESTMENT

This Derivative Risk Management Statement (“DRMS”) has been prepared for statutory funds 1, 2, 3 and the shareholder funds (collectively the “Funds”) of TOWER Australia Limited (“TAL”), ABN 70 050 109 450, Australian Financial Services licence number 237848.

2. REGULATORY ENVIRONMENT

This DRMS has been prepared pursuant to Australian Prudential Regulation Authority (“APRA”) Prudential Standard LPS 220 Risk Management (LPS 220) and Prudential Practice Guide LPG 250 Asset and Liability Management Risk (LPG 250). It incorporates the requirements of Life Insurance Regulation 1995 – Reg 4.00A.

3. OBJECTIVE OF THIS STATEMENT

This DRMS sets out the risk management policies for the TOWER Australia Limited Board (the “Board”) in relation to the use of derivatives in achieving the various investment strategies of the Funds.

This DRMS should be read in conjunction with TAL’s *Strategic Asset Allocation Plan and Investment Management Policy*.

TAL has outsourced certain aspects of its investment management functions. As such, this DRMS should be read in conjunction with the Derivative Risk Statement (“DRS”) of TAL’s appointed investment managers (as identified in Schedule 1) as well as the relevant Investment Management Agreement (“IMA”) and/or Product Disclosure Statement (“PDS”) of these investment managers.

Objectives in using derivatives

Derivatives are defined in LPG 250 as “financial contracts, such as forwards, futures, swaps, options, and other similar transactions, that are derived from an underlying asset”.

In implementing the investment strategy for each investment option within the Funds, derivatives may be used to create or remove exposures that would otherwise be established through the physical market, or to provide a cheaper, more efficient or liquid way to implement investment decisions. More specifically, derivatives may be used to achieve one or more of the following objectives:

- Protect an asset of a Fund against, or minimise liability from, a fluctuation in market values;
- Manage volatility;
- Achieve transactional efficiency in the achievement of the best execution of security transactions;
- Control the impact on portfolio valuations of market movements caused by significant transactions;
- Adjust the duration of a fixed interest portfolio;
- Reduce the transaction cost of achieving targeted exposures;
- Reduce the time taken to achieve a desired level of market exposure;
- Obtain prices that may not be available in the physical market; and/or
- Adjust asset exposures within the parameters set in the investment strategy.

4. RISKS OF USING DERIVATIVES

Risk is an inherent factor in managing investment portfolios. Some of these risks may include:

- *Credit Risk*: A financial loss suffered through the default of a financial counterparty whether due to the financial insolvency of the counterparty, the ability of the counterparty to perform due to country decree, or any other circumstance.
- *Liquidity Risk*: The inability to realise assets in a timeframe required to make payments or at a fair price, or the requirement to pay collateral on mark-to-market price movements.
- *Equity Price Risk*: A form of market risk related to the general volatility of equity prices.
- *Interest Rate Risk*: A form of market risk related to movements in interest rates.
- *Currency Risk*: A form of market risk related to movements in currency markets. This risk applies to asset exposures that are unhedged.
- *Operational Risk*: Financial loss due to the mismanagement, error, fraud, or unauthorised use of techniques and/or financial products.
- *Derivatives Risk*: Derivative instruments in underlying investments are transacted in a manner that fails to fulfil the investment objectives, or are not taken out in circumstances where it would be prudent to do so.

TAL's risk tolerances and risk management strategies in relation to investment management functions are addressed in the *Investment Management Policy*. In addition, risks in relation to derivatives usage by TAL's appointed investment managers are outlined in the DRS and PDS (where relevant) of each manager.

5. INVESTMENT STRATEGY & OBJECTIVES

The investment strategy and objectives for each unit linked investment option or non-unit linked product group within the Funds is contained in the *Strategic Asset Allocation Plan* adopted by the Board. Any change in investment objective or strategy is approved by the Board.

6. EXPOSURE LIMITS, COMPLIANCE PROCESSES & CONTROLS

TAL has outsourced certain aspects of its investment management functions. As such, TAL does not use or acquire derivative instruments directly. TAL's Australian Financial Services (AFS) Licence does not permit direct derivatives trading.

Derivatives may be used by TAL's appointed investment managers in managing the Funds. TAL retains a current copy of the DRS issued by the investment managers who invest, either directly or indirectly, on TAL's behalf.

Derivatives are not considered in isolation, but as part of the investment strategy for each Fund. Derivative exposure combined with physical exposure should not result in a net exposure which is inconsistent with these investment strategies.

Investments via Collective Investment Vehicle (“CIV”)

TAL has reviewed the investment objectives, investment strategy and derivative policy of the CIVs in which it has chosen to invest and is satisfied the investment guidelines in relation to the usage of derivatives are appropriate and consistent with the objectives and strategies of the TAL investment options.

TAL shall reassess the objectives, strategy and derivative policy whenever a CIV offer document or DRS is updated and, in any event, at least once in each calendar year as part of the annual review of this Policy.

Direct investments via IMA

The investment objectives, strategies and limitations relating to investments, including the use of derivatives (if any), are set out in the IMA with the investment manager. The investment manager is required to manage the portfolio of securities within the limits and guidelines specified in the IMA.

Monitoring & Reporting for Direct investments

Derivative exposures within direct investments will be monitored by TAL on a monthly basis and reported to the Executive Investment Committee (“EIC”). Material findings outside the allowable limits specified in the IMA will be reported to each meeting of the TOWER Australia Group Limited (“TAGL”) Investment Committee (“GIC”) which is responsible for oversight of TAL’s investment management activities.

The Minutes of the EIC are distributed to the GIC.

The Minutes of the GIC are distributed to the TAL Board.

Controls on Derivative Usage

TAL relies on the controls employed by its appointed investment managers that take into consideration the expertise of staff. As part of its compliance processes, TAL obtains evidence that these controls are effective in the form of external audit certifications from the investment managers.

7. IDENTIFICATION OF INVESTMENT MANAGER DRS

The effective date of the latest DRS of the investment managers appointed by TAL is listed in **Schedule 1**.

Each of these DRS refers to the appointment of an external auditor by the investment manager to sign off annually that the DRS exists, that the major procedures laid down in the DRS have been followed, and that any changes have been approved by the investment manager. TAL seeks annual confirmation that each DRS issued to TAL is subject to external audit.

8. ROLES AND RESPONSIBILITIES, QUALIFICATIONS & EXPERIENCE

TAL monitors and reports compliance with this DRMS to the EIC on a monthly basis and to the GIC at each meeting.

The Board monitors compliance with this DRMS via regular reporting from the GIC.

TAL staff who monitor derivatives policies and usage are independent of those who undertake derivatives trading within TAL’s appointed investment managers.

Members of the GIC, EIC and TAL staff involved in such monitoring have sufficient qualifications, skills and experience to undertake these roles. All are aware of this DRMS, and will be provided with a copy of any changes on a timely basis.

No employee of TAL and its related bodies corporate (as defined under the Corporations Act 2001) receives any remuneration, bonus or other inducement related to the trading of derivatives or for excessive risk taking.

TAL monitors the DRS of the investment managers and seeks such additional information as it considers necessary to ensure that the investment managers and their respective staff:

- are suitable qualified to undertake derivatives trading and compliance monitoring; and
- do not receive incentives for excessive risk taking.

9. DATE OF AUTHORISATION

This DRMS has been duly approved and authorised by the TAL Board on 11 August 2010.

SCHEDULE 1

The table below lists the effective date of the latest DRS for each investment manager in which TAL has chosen to invest and which use derivatives as at the date of this Policy:

Investment Manager	DRS Date	Audit Opinion
AMP Capital Investors Limited	March 2010	March 2010 (E&Y)
Russell Investment Management Ltd	December 2009	July 2009 (PwC)
Vanguard Investments Australia Ltd	July 2009	August 2009 (PwC)
MLC Investments	November 2009	TBA
Aberdeen Asset Management (Australia) Limited	March 2009	September 2009 (KPMG)