



The Government of the Republic of Nauru

Investment Policy Statement for the Intergenerational Trust Fund for the people of the Republic of Nauru

Effective June 2016

1) PURPOSE

- a) The purpose of this Investment Policy Statement is to:
- State the principles and investment beliefs for the management of the Intergenerational Trust Fund for the people of the Republic of Nauru ("Investment Fund").
 - State the investment objectives and investment strategy for the Investment Fund.
 - State the principles that will be used to manage risk and monitor the performance of the Investment Fund.

2) BACKGROUND

- a) The Intergenerational Trust Fund for the people of the Republic of Nauru was established on 6 November 2015. The Investment Fund is administered by the Trust Fund Committee ("Committee")
- b) The Investment Fund has been established with the purpose of generating future investment earnings that can be used to provide a source of revenue to the Republic of Nauru post-2035, or at a time sooner as determined by the Committee, for investments in education, health, environment and infrastructure. The Fund will help to smooth out windfall income streams in the medium term and replace all or part or supplement volatile future revenue.
- c) The Investment Trust is domiciled in Australia and receives income tax exempt status.

3) RESPONSIBLE PARTIES AND FIDUCIARY DUTIES

- a) Responsibility for the Investment Fund rests with the Committee. Individuals serving on the Committee are termed "Members." The Committee can delegate responsibilities and administrative powers as necessary through formal appointment.
- b) In making decisions on investment strategy, the Committee will have regard to the overall circumstances of the Republic of Nauru and will comply with all applicable legislative requirements.
- c) With respect to asset management, the oversight responsibility of the Trust Fund rests with the Committee composed of individuals whose responsibilities encompass the following:
- Establishing overall objectives and the setting of investment policy;
 - Monitoring the management of the Investment Fund's assets;
 - Reviewing the asset allocation mix on a regular basis to ascertain not only that the existing portfolio conforms to the desired targets and ranges, but also that the targets and ranges remain suitable and represent the prudent asset allocation mix for the Investment Fund;
 - Monitoring performance to determine whether or not the rate of return objectives are being met and that Policy and guidelines are being followed; and
 - Taking appropriate action if objectives are not met or if Policy and guidelines are not followed.
- d) The Committee will use an "implemented consulting" approach to gain access to investment managers. An implemented consulting approach involves outsourcing the selection of investment managers to an appropriately qualified third party organisation. This provides the benefits of:
- Access to multiple investment managers through one point of contact, while also providing,
 - Diversification of risk through an exposure to a range of investment managers with complimentary risk profiles,
 - The ongoing monitoring and proactive management of these investment manager appointments, and

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- Access to the insight and dynamic adjustments to asset class weights that may be implemented by the implemented consultant from time to time in order to manage the portfolio as the balance of risks change in global markets.
- e) The appointed “Implemented Consultant” has the responsibility of advising on investment strategy, asset allocation, investment manager selection & implementation, and the monitoring of investment performance. Specifically, the Implemented Consultant will be responsible for the following:
- Monitor long-term capital market trends and suggest broad-based asset-allocation policies to be approved by the Committee and implemented by the Implemented Consultant.
 - Appoint and terminate investment management firms (“Investment Managers”), as appropriate to implement the Managed Assets’ investment policies and objectives.
 - Rebalance the portfolio in accordance with this Policy.
 - Document the Investment Fund’s investment policies and objectives and review the Policy on an annual basis, and suggest appropriate changes.
 - Measure, evaluate and report in writing the Investment Fund’s assets and performance results monthly and quarterly, including reporting on the performance results of the underlying asset classes versus appropriate benchmarks.
 - Meet with the Committee as agreed.
- f) The Committee will utilise the services of a number of external professional investment managers to manage the assets of the portfolio.

4) INVESTMENT PRINCIPLES AND BELIEFS

- a) The Trust Fund Committee will seek to achieve the maximum long term investment return for its defined tolerance for risk. It is acknowledged that the investments made by the Original Partners and other contributors are subject to risk and that in certain periods this can result in (realised or unrealised) losses. These investment risks include but may not be limited to:
- Market risk: The movement of markets resulting from the effects of prevailing economic conditions, government regulations and policy decisions, investor sentiment, political, environmental and technological issues.
 - Currency risk: The change in the value of investments in non-Australian dollar currencies as a result of converting the returns back to AUD.
 - Interest rate risk: Changes in interest rates affect the value of fixed interest securities, companies cost of borrowing, the rate banks pay on term deposits and the value of the currencies.
 - Credit (default) risk: The risk of a loss as a result of the creditworthiness of a borrower or counterparty being downgraded or failing to meet its obligations, whether they are in the form of fixed interest securities or derivatives.
 - Illiquidity risk: The risk that an investment may not be easily sold for cash as a result of limited sale opportunities, market disruptions or insufficient market participants.
- b) In managing the assets of the Investment Fund, the Committee will seek to minimise the frequency and severity of negative returns (capital losses) in any year such that this risk is consistent with the long term risk profile. This risk tolerance is quantified as part of the Investment Objectives for the Investment Fund.
- c) The Committee does not invest directly in derivatives, however it is understood that the implemented consulting solution and/or the underlying investment managers may use derivatives in the prudent management of their portfolios.

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- d) The Committee expects the Investment Fund to be invested consistent with best practice for sovereign wealth funds.
 - e) The portfolio will not be leveraged.
 - f) Investment risk will be limited by appropriate diversification between and within investment asset classes.

5) INVESTMENT OBJECTIVES

- a) It is acknowledged that this is a long term investment fund and as such the investment objective is to maximise investment returns over the long term, taking into account the Committee's appetite for risk.
- b) The investment return objective is to achieve a total return of 3.5%pa (after fees) over inflation (as measured by the Australian Consumer Price index) over rolling 10 year periods.
- c) This level of return is sought with the following risk objective:
 - To limit the number of negative returns to less than 4 negative years in 20
 - To limit the severity of negative returns to less than -18%. This is calculated as the average expected loss in the worst 5% of future outcomes (cVaR).

6) INVESTMENT STRATEGY

- a) The Committee understands that the Investment Fund has a long term investment horizon and a high exposure to growth assets is appropriate to generate strong real investment returns. The investment strategy for the Investment Fund will be undertaken in the following stages and will take into consideration relevant memorandum of understandings, funds under management and market conditions:
- Stage 1 – years 0 - 3: The strategy is to build the capital base of the Investment Fund by investing the funds within a diversified investment option with an allocation of 70-75% to growth assets.
 - Stage 2 – years 4 – 15: The objective will be to increase the allocation to growth assets to increase the real return potential of the Investment Fund. The Investment Fund will transition to a bespoke allocation of growth assets with an allocation above 80%.
 - During this stage a “glidepath” will be formulated that will guide the investment strategy towards maturity and the initial distribution from the investment fund.
 - Stage 3 – years 16 – 20: In accordance with the formulated “glidepath”, the investment fund will gradually reduce the allocation to growth assets in a segment of the total portfolio to provide sufficient liquidity to allow distribution of earnings consistent with paragraph 14 of the MOU. Note that a significant proportion of the portfolio is anticipated to remain in growth assets.
 - Stage 4 – years 20 and beyond: consistent with stage 3 a significant proportion of the fund will be retained in growth assets with ongoing review to ensure sufficient liquidity to enable annual distributions of earnings (consistent with paragraph 14 of the MOU).
 - These stages will be annually reviewed throughout the term of the Investment Fund by the Committee and the Implemented Consultant.
- b) The Trust Fund Committee’s strategic asset allocation and tolerance ranges are set out below:

Asset Class	Strategic Asset Allocation	Tolerance Ranges
Growth Assets	73%	60 – 90%
Defensive Assets	27%	10 – 40%
Australian Shares	27%	15 – 45%
International Shares	28%	15 – 45%
Property and Infrastructure	13%	5 – 30%
Alternative Assets	6%	0 – 15%
Higher Yielding Fixed Interest	5%	0 – 15%
Defensive Fixed Interest & Cash	21%	10 – 40%
TOTAL	100%	

- c) The strategic asset allocation will be reviewed against the stated investment objectives on an annual basis.

7) MONITORING AND REPORTING

- a) In order to monitor the performance of the Investment Fund, the Committee will receive a comprehensive investment report from the implemented consultant on a quarterly basis. This report will assess:
- the extent to which the investment objectives are being achieved,
 - the performance of the Investment Fund as a whole as well as the performance of investment managers relative to the notional return of a benchmark portfolio designed to reflect the strategic asset allocation and risk profile in which the assets are invested. The notional return of the benchmark portfolio will be measured

as a weighted benchmark comprised of the Investment Fund's strategic asset allocation benchmark and the performance benchmarks listed below:

Assets Class	Benchmark/Index
Australian Shares	S&P/ASX 300 Accumulation Index
Australian Small Companies	S&P/ASX Small Ordinaries Accumulation Index
Overseas Shares	MSCI World Index (ex Aust) in \$A with net dividends reinvested
Overseas Shares (Hedged)	MSCI World Index (ex Aust) - in hedged \$A with net dividends reinvested
Overseas Small Companies	MSCI World Small Cap Index
Emerging Markets	MSCI Emerging Markets Free Float Index
Direct Property	Australian CPI + 4%
Listed Property	FTSE EPRA/NAREIT Developed Index—in \$A (Hedged)
Unlisted Infrastructure	Australian CPI +3%
Listed Infrastructure	FTSE Global Core Infrastructure 50/50 Index
Natural Resources	45% DJ UBS Commodity Index (hedged to A\$) 15% S&P Goldman Sachs Agricultural Index 40% CPI + 5%
Diversified Alternatives	Bloomberg AusBond Bank Bill Index
Australian Sovereign Bonds	Bloomberg Australian Treasury Bond Index 0+ (All Maturities)
Overseas Sovereign Bonds	JP Morgan Customised Benchmark
Australian Inflation Plus	Australian CPI +1%
Emerging Markets Debt	JP Morgan GBI-EM Global Diversified Index (unhedged)
Global Credit	60% - Barclays Global Aggregate - Corporate Index (A\$ Hedged) ; 40% - Barclays Capital Global Aggregate ex Government ex Treasuries Index (A\$ Hedged)
Cash	Bloomberg Bank Bill Index

- b) The Implemented Consultant will report on any major shifts in investment strategy which have been implemented or any significant change in the management structure or other characteristic of the investment managers and the whole portfolio.
- c) The continued appropriateness of the strategic asset allocation will be assessed by the "Implemented Consultant" once per annum or in the event of a significant change in economic circumstances.

8) CASH FLOW AND DISTRIBUTIONS

- a) The Fund will begin Distributions in 2035 or at a time sooner as determined by the Committee if the Committee determines that the Fund has reached a Current Value that the Committee considers feasible to provide the Government of the Republic of Nauru with a source of revenue to replace revenue reductions of any naturally based resource stream.
- b) The Investment Fund is expected to receive annual contributions from donors in the order of \$A10m - \$A15m per annum until 2035. The cash flows are dependent on the economic environment and the "Memorandum of Understandings" between the Government of the Republic of Nauru and its development partners.

9) REVIEW OF THIS INVESTMENT POLICY STATEMENT

- a) This Investment Policy Statement will be reviewed by the Committee and/or the implemented consultant at least every two years.
- b) This Investment Policy Statement will come into effect from 6 June 2016.

10) CONFLICT OF INTEREST POLICY

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- a) These guidelines apply to the Committee, the Investment Managers, the Custodian, the Manager, the Implemented Consultant and any employee or agent retained by any of the foregoing to provide services to each Trust.
 - b) Any such person shall disclose any direct or indirect material association or material interest or involvement in aspects related to his or her role with regard to the Investment Fund's investments that would result in any potential, perceived or actual conflict of interest. Without limiting the generality of the foregoing, this would include material benefit from any asset held in the Investment Fund, or any significant holdings, or membership on the board of directors of any corporations, or any actual or proposed contracts.
 - c) If an potential, perceived or actual conflict of interest arises or appears likely to arise during the course of a person's involvement with the Trust, any such person involved shall disclose the nature and extent of the conflict to the Committee in writing. Disclosure shall also be made orally if knowledge of a potential, perceived or actual conflict of interest arises in the course of discussion at a meeting of the Committee. Upon giving notice, the person or persons will refrain and withdraw from all discussions and participation in decisions pertaining to those matters where a conflict of interest exists or is perceived to exist, except where the conflict has been resolved or appropriately managed, and subject to the terms and conditions set forth under applicable law and regulation.

Appendix 1 – Capital Market Assumptions

Asset Class	20 Year Geometric Return	20 Year Standard Deviation
Australian Equities	8.4%	17.6%
Australian Small Companies	8.9%	20.2%
International Equities	8.0%	16.3%
International Equities (Hedged)	8.0%	16.8%
International Small Companies	8.5%	19.0%
Emerging markets	8.6%	21.5%
Australian Direct Property	7.6%	9.6%
Global Listed Property	7.7%	17.3%
Listed Infrastructure	7.3%	12.8%
Unlisted Infrastructure	7.7%	8.8%
Diversified Hedged Funds	7.7%	11.9%
Private Equity	11.0%	22.7%
High Yield	6.2%	12.2%
Private Debt	9.4%	11.2%
Emerging Markets Debt	4.9%	9.1%
Australian Sovereign Bonds	3.9%	4.2%
Australian Non-Sovereign Bonds	4.6%	5.0%
International Sovereign Bonds	3.7%	4.5%
International Non-Sovereign Bonds	4.6%	5.8%
Cash	4.1%	1.2%

Asset Class	10 Year Geometric Return	10 Year Standard Deviation
Australian Equities	8.4%	17.6%
Australian Small Companies	8.9%	20.2%
International Equities	8.1%	16.2%
International Equities (Hedged)	8.1%	16.9%
International Small Companies	8.6%	18.9%
Emerging markets	8.9%	21.2%
Australian Direct Property	7.4%	9.7%
Global Listed Property	7.8%	17.3%
Listed Infrastructure	7.0%	12.7%
Unlisted Infrastructure	7.5%	8.8%
Diversified Hedged Funds	7.4%	11.9%
Private Equity	10.9%	23.3%
High Yield	5.3%	12.4%
Private Debt	9.1%	12.1%
Emerging Markets Debt	4.6%	8.9%
Australian Sovereign Bonds	3.1%	3.5%
Australian Non-Sovereign Bonds	3.8%	5.0%
International Sovereign Bonds	2.6%	3.8%
International Non-Sovereign Bonds	3.7%	5.6%
Cash	3.7%	1.0%

The Capital Market Assumptions are updated on a quarterly basis. They will be updated in the Investment Policy Statement as part of the annual strategic review.

Approved by the Chairman of the Committee: Hon David Adeang M.P. on 17th June 2016.