Policy: Investment

Purpose
The purpose of the Investment policy is to articulate the principles that govern the investment strategy of the University for investible funds entrusted to it.

Overview
The Investment Policy Statement and its associated investment policies details:

- The framework supporting the University’s investments.
- The nature of socially responsible investments that guides the University’s investment philosophy.
- The strategies adopted by the Council to achieve the set of investment objectives.
- The risk and return objective of the University’s General Cash Float portfolio.
- The risk and return objectives of the University’s Long Term Investment Pool.
- Appropriate long term strategic asset allocation and asset allocation ranges.
- Stress testing program.
- The dynamic asset allocation process.
- The measuring, monitoring and reporting of performance.
- The process for reviewing investment strategy.

The investment objectives, strategies and constraints of the portfolio are stated in quantifiable terms for the purpose of measurement and accountability. The Council (or its delegate) must determine an investment strategy for the portfolio (the investment strategy) and a strategy for the prudential management of any reserves of the portfolio (the reserves strategy). The investment strategy will have regard to the circumstances of the portfolio, including all legislative and regulatory requirements.

The Investment Policy Statement is designed to provide sufficient flexibility in the management and oversight process recognising the dynamic nature of the investment environment, while setting forth reasonable parameters to ensure prudence and care in the implementation of the Council’s investment strategies for the portfolio. This Investment
Policy Statement provides broad guidance relating to the oversight and management of the University’s investment assets.

This policy should be read and used in conjunction with the following policies:

- Finance Committee Charter and related investment policies
- Risk Management Framework
- Governance Framework
- Business Plan

Scope

This Policy applies to all funds held in the University’s investment portfolio.

Definitions

**ANU Act** means the *Australian National University Act 1991*.

**CPI** mean Consumer Price Index.

**DAA** means the dynamic asset allocation.

**Derivatives** are financial instruments whose value and marketability are derived from the value of an underlying asset, liability or index which represents either the direct ownership of an asset or the direct obligation of an issue. Derivatives include financial instruments that trade on an organised exchange or “over-the-counter” (OTC) and which include, but are not limited to, futures, swaps, forwards, warrants and options.

**Fund** means LTIP plus GCF.

**GCF** means the General Cash Fund.

**LTIP** means the Long Term Investment Pool.

**Relevant law** means the *Australian National University Act 1991*, the *Corporations Act 2001* (and associated regulations), or APRA’s *Prudential Standard SPS 530 Investment Governance and Prudential Practice Guide SPG 530 Investment Governance*.

**PGPA Act** means the *Public Governance, Performance & Accountability Act 2013*.

**SAA** means strategic asset allocation.

Policy statement

Background

1. The Australian National University is a body corporate established by the *Australian National University Act 1991*. The University is considered a “corporate Commonwealth entity” under the *Public Governance, Performance & Accountability Act 2013*. The ANU
Act grants to the University a series of exemptions from sections of the PGPA Act dealing with limitations on investment powers and compliance with the policies of the Australian Government.

2. Section 9 of the ANU Act confers upon the Council the power over the University, granting it entire control and management of the University. Under section 17 of the ANU Act, the Council delegates to the Vice-Chancellor the power to “control and manage the affairs and concerns of the University.”

3. The Council recognises its fiduciary duty to administer the investment portfolio prudently for the benefit of the University and the unit holders. The Council is supported in this regard through its Finance Committee.

4. The University’s Long Term Investment Pool has a long term investment horizon reflecting its perpetuity. The distribution parameters determines the framework used in the distribution of income generated by the portfolio to unit holders.

5. Unit prices on the LTIP, and hence returns accruing to unit holders, are determined so as to closely reflect the investment returns recorded on the underlying investments. Accordingly, unit holders bear the investment risk in that the investment returns recorded are reflected directly in changes to the monthly unit price of the LTIP.

6. The LTIP Application and Redemption Guideline outlines the process for accepting applications into the LTIP and redemptions from the fund by unit holders.

Setting the investment strategy

7. The Council determines an appropriate investment strategy for the University as a whole and for the underlying Long Term Investment Pool and the General Cash Fund. Setting the investment strategy is a continual process that aims, first and foremost, to ensure alignment between agreed investment objectives and the structure of the investment portfolio. In doing so, the interests of the University remain at the forefront of the Council’s mind.

8. In setting objectives, the Council recognises that the objectives are intentions and that they may not be achieved in any particular time frame. The intention will be to achieve the risk/return objectives as frequently as possible.

9. The Council recognises the achievement of competitive long-term investment returns will require the portfolio to accept investment risk. In accepting the need to take investment risk, the Council has identified certain factors that have a critical influence on the investment performance. These are:

- The setting of investment objectives to reflect the best interest of the University
- The strategic asset allocation
• The dynamic asset allocation
• The University’s liquidity position.
• The monitoring and management of changes in market conditions in order to achieve the targeted investment objectives.
• The oversight and management of investment activities in a timely manner to ensure that internal controls, processes and governance are sufficient to efficiently detect any potential errors, deficiency or breakdown in systems.
• The oversight and monitoring of the University’s foreign currency exposure in the investment portfolio as well as hedging activities in compliance with policy.
• The oversight and monitoring of the Custodian to ensure that the Fund’s settlements take place in a timely and efficient manner and that the fair value of assets are established and recorded.

Investment philosophy

10. The Council views the LTIP to be a long term investment vehicle. The GCF is viewed as a short term investment vehicle. The Council professionally manages the assets supporting those portfolios with the aim of assisting stakeholders in achieving their desired investment outcome.

11. The following set of investment beliefs informs the investment strategy setting process of the University:

• Return requires risk but risk does not guarantee return, i.e. achieving a return in excess of the risk free return requires taking on incremental risk of some description.
• Risk and return are related. Capital markets are usually reasonably efficient in pricing financial risk, in the sense that, if the expected return on one asset exceeds the return on an alternate asset, there is normally an additional risk entailed in holding the former asset. However, capital markets are also complex and not always rational. Theories such as the Efficient Markets Hypothesis are frequently violated in practice.
• Diversification reduces risk. By combining assets with various unique risk characteristics may reduce the volatility of portfolio returns.
• Risk is more multifaceted than the short term volatility of returns. At the portfolio level, short term volatility may not be a relevant risk measure when risk is considered to reflect the failure to meet the investment objective. While high levels
of volatility may be indicative of high failure risk, the potential for large negative returns may also have a large bearing.

- At the portfolio level, risk is related to a failure to meet objectives. The failure to meet the objectives is the ultimate definition of risk for a fiduciary. The relevant dimensions of this risk are the chance that it will occur, the circumstances in which it will occur and the extent of a shortfall faced when it does occur.

- Active management can add value. In some markets, participants do not all have return-maximising objectives and/or some participants are likely to underperform on average. Active professional investment management can, on average, add value in such markets.

- Behavioural issues are important. Behavioural issues apply at the security level, at the asset class level and in constructing total investment portfolios. At all of these levels, these issues can, in some circumstances, exert a more powerful influence on markets than rational economic optimisation.

- Costs and implementation leakage matter. Fees, brokerage, taxes and opportunity costs from being “out of the market” must all be considered both in on going portfolio management and when restructuring portfolios.

- Long term returns are expected to be superior when members are able to take a genuinely long term perspective.

- Corporate social responsibility, ensuring socially responsible investing behaviours are maintained throughout the execution of the investment strategy.

12. The Fund considers that investment strategies should take into account the following Fund profile factors: investment time frame, stakeholder’s expectations and factors that influence the University’s risk tolerance so as to achieve the strategic objectives. Strategy objectives should reflect “SMART” characteristics:

- **Specific**
- **Measurable**
- **Achievable**
- **Realistic**
- **Time-Bound**

13. The strategy objective must clearly state a quantifiable return target that is both attainable and measurable over a specified time period. The following investment objectives are intended to assist in achieving this goal:
• the individual investment strategies should seek to earn a return in excess of its policy benchmark over the long term;

• the portfolio's assets will be managed on a total return basis which takes into consideration both investment income and capital appreciation;

• the importance of the preservation of capital, and adherence to the principle that varying degrees of investment risk are generally: rewarded with compensating returns; consistent with long term growth objectives, to invest in a manner which provides a degree of downside protection in declining markets; and to assess investments on a tax-effective basis where applicable.

Formulating investment strategy

14. Following the adoption of appropriate risk and return objectives, the Investment Office formulates the investment strategy for endorsement by the Finance Committee and approval by the Council. The Investment Office determines:

• Risk and return assumptions for each asset class.

• Modelling is undertaken to determine the desired long term asset allocation that is expected to maximise the probability of achieving the stated return objective, subject to the targeted level of risk and any other constraints, while ensuring adequate diversification of risk premia on a look through basis (using risk factor analysis).

• In developing the desired asset allocation, the scheme aims to maximise diversification on a look through basis using risk factor analysis. A “look through basis” means examining the underlying exposures of the portfolio, a process of looking through all the layers and ascertaining the foundational risks associated with each asset class.

• Stress testing is undertaken to assess the robustness of the asset allocation and better understand the risks embedded in the portfolio.

• The benchmark portfolio is then finalised taking all aspects of the analysis into consideration.

Consideration of investment covenants

15. In taking decisions on investment strategy, the Council will have regard to the overall circumstances of the portfolio as well as the particular circumstances pertaining to the University, and will comply with all applicable legislative requirements.

16. The Fund’s investments will be managed with a view to ensuring that the Fund will have sufficient liquidity to meet expected cash flow requirements.
Developing strategic asset allocations for LTIP

17. The long term strategic asset allocation anchors the portfolio’s investment strategy. The portfolio’s SAA decisions dominate the investment outcome. In determining the SAA for the LTIP, the Investment Office relies on modelling undertaken by its asset consultant and aims to balance risk and return to maximise the probability of achieving its stated objectives.

18. Long term return assumptions are primarily used for the purpose of calculating the level of investment risk inherent in the investment strategy expressed as the likely number of negative annual returns over a 20 year period. This calculation uses a risk premia based approach.

19. These assumptions are primarily derived using a risk premia approach. The starting point is the lowest risk asset class (cash) and then adding return premiums for other classes to reflect compensation for the additional risk.

20. These return premiums are based on long term capital market history and research of the fundamental risk and return characteristics of each asset class.

21. Expected long term returns are checked for reasonableness by using a fundamental or economic based approach. A qualitative overlay is also applied to ensure return assumptions are appropriate and are consistent across asset classes.

22. Assumptions for standard deviations are largely based on history. Consideration is also given to rolling volatility charts to check how volatility has varied over time and considering if there are any reasons to expect volatility levels to change going forward.

23. Asset class correlation assumptions are also largely based on history (to the extent history is relevant), with checks for trends similar to what is undertaken for volatility. Note that correlations between risky assets increase during times of market crisis.

Assessing underlying risk factors

24. As part of the investment strategy, the Council considers the degree of diversification embedded in the Long Term Investment Pool using risk factor analysis.

25. Common risk factors tend to drive returns across multiple asset classes. Diversification is often less effective than can appear to be the case when viewing asset allocation analysis in isolation. Understanding this allows the Council, the Investment Office and its adviser to avoid unintended concentration of risk and develop portfolios that are more effectively diversified. The risk factors identified are:

- Equity Risk Premium: the premium expected from investing in developed large cap equities above the risk-free rate.
• Small Cap Premium: the additional return expected from investing in small cap companies compared to developed large cap companies.

• Emerging Markets premium: the additional return expected from investing in emerging markets relative to developed market equity.

• Term premium: the premium expected from investing in government bonds (fixed terms bonds) relative to the risk-free rate.

• Credit Spread Premium: the premium expected from exposure to credit risk (for example, investing in high yield bonds compared to government bonds).

• Inflation expectation: the difference between the long term average expected inflation and short term unexpected inflation.

• Liquidity Factor: the higher rates of return expected to compensate for the disadvantages of holding less liquid assets.

• Non-Corporate GDP Growth: the returns on assets such as property will be partially explained by GDP growth that is not directly linked to the corporate sector.

• Alpha: in addition to the factor-driven returns, the model allows for “alpha” in asset classes that cannot be managed passively to capture stock specific risks and other unique premia. This reflects alpha that is embedded into beta returns, rather than alpha generated through manager skill.

26. As expected, equity risk tends to dominate the growth orientated portfolio. This is required to achieve higher returns and is appropriate given the longer investment horizon of the LTIP.

Stress testing program

27. The Council acknowledges that stress testing is an important aspect of the investment strategy. Understanding how the portfolio may perform through periods of market stress helps unitholders, stakeholders and Council to prepare for and manage the portfolio and mitigate risks. This analysis is undertaken in two parts:

• Historical analysis; and

• Simulation analysis.

28. Historical analysis is used to determine the likely impact on portfolio returns from a selection of historical distressed market events. Each historical shock is assessed on a peak to trough basis to identify the potential for extraordinary loss by comparing return outcomes for the portfolio to its objectives. Potential implications for portfolio management are also considered, such as the likelihood of breaching strategic asset allocation ranges
and (where relevant) the need to fund losses on the LTIP’s foreign currency hedge overlay.

29. Although the Finance Committee does not expect history to repeat itself, historic stress tests do provide powerful insight that are factored into the investment strategy process. A key benefit of this type of stress test is that it is objective in nature and inherently captures the complex interrelationships between markets and asset classes during periods of market stress.

30. Simulation stress tests provide a forward looking assessment of the potential for extraordinary loss. This analysis ties indirectly into the Investment Office’s SAA modelling. The model produces possible portfolio outcomes in a manner that reflects the multifaceted and dynamic nature of markets. As discussed above, the fundamental model incorporates historical asset class volatility and historical correlation convergence to determine mean-reverting asset class return expectations.

**Implementation**

31. The University implements its investment strategy through the appointment of one or more external asset managers that have responsibility for the investment of the Fund's assets.

**Asset Manager selection**

32. The Council recognises its fiduciary duty to administer the Fund prudently for the benefit of all stakeholders. Prudent administration requires the Council not only to diversify its investments but to conduct due diligence on new asset managers as part of the selection process.

33. Due diligence shall be conducted on new asset managers as part of the selection process. The Director of the Investment Officer will perform or cause to be performed all necessary and reasonable due diligence with respect to the final slate of asset managers being considered for engagement by the Fund.

34. Asset Managers must be shown to have adequacy in the following areas:

- Organisational competency
- Experienced investment staff
- Performance track record with similar mandates
- Commercial, operational, legal and taxation issues including holding necessary licenses
- Information technology systems
• Risk control procedures
• Quality client reporting.

35. Prior to selecting an asset manager, the candidate will complete an in-depth questionnaire concerning investment philosophy, style and process, including operational and compliance risk management. There will be on-site evaluations of short listed candidates where possible.

36. As part of this process the Council also considers whether the investment should be made via a segregated mandate or investment trust. Consideration is given to issues such as transparency, control, cost and other aspects. The Council prefers investment via a segregated mandate.

37. Formal approval to proceed with implementation will only occur once the Investment Office is satisfied that the necessary due diligence has been completed and that there is sufficient understanding of how the investment strategy is expected to perform (including under a range of stressed scenarios).

**Performance and investment monitoring**

38. LTIP’s performance objective is to achieve a net return of CPI + 3.5% over a rolling 7 year period. The expected frequency of a negative return is once in a 5 year period. The SAA is tested regularly to ensure that the LTIP is fit for purpose to achieve its return objective.

39. The Council, through its Finance Committee, meets on a regular basis to consider how the Fund is performing relative to the set investment objectives. The monitoring process aims to proactively identify potential issues or areas of concern, investigate these thoroughly and take action where appropriate.

40. The Council, through its Finance Committee, formally reviews each asset class annually or sooner if required.

• Overall performance and performance of each underlying manager relative to objectives and peers;
• Style characteristics, including whether any unintended risks/biases are present in the portfolio;
• Whether it is possible to construct the portfolio more efficiently; and
• The forward looking level of conviction in incumbent managers relative to their potential managers or products or styles.
41. Performances for individual asset classes are measured against suitable industry standard indices. The Council considers the indices detailed in Appendix A are appropriate for the asset classes in which Fund assets are invested.

42. In monitoring its investments, the Council will receive regular input from a number of sources, including the Custodian and other investment professionals.

43. Each external asset manager is required to monitor and review their mandate regularly, to ensure that it meets the conditions of the outlined investment management agreement. The manager is required to inform the Investment Office if there is a breach. In addition, a monthly mandate compliance review will be undertaken by the Custodian.

44. The Council may choose to review a manager’s mandate upon the occurrence of the following circumstances:

- Material alteration to the structure of the Fund;
- Significant changes in the underlying economic assumptions used in the development of the Fund’s objectives;
- Significant modifications required arising from a revision to the expected optimal long-term asset allocation;
- Deficiencies in the objectives/policies that emerge in their practical operation;
- Operational errors;
- Compliance issues identified by the Custodian; and
- Performance.

45. The Investment Office engages in regular dialogue with its Asset Managers on investment matters as the need arises. These matters would include:

- Assistance with administrative issues generally;
- Timely commentary on significant market events;
- Timely notification of investment actions that may draw media, Government or member attention;
- Advice on economic conditions that may affect investment returns and objectives, international political events, changes in real return expectations, and general changes in economic conditions;
- Significant changes in personnel or in the business operations of the manager;
- Returns on individual sectors, including events which have a significantly adverse impact on the return of the portfolio; and
- Year-end review of projected returns for the following 12 months.

46. Regular meetings with the Fund’s asset managers including conducting regular, periodic on-site examinations of the managers, as part of its on-going due diligence will take place. The Council seeks to evaluate the operational and financial performance of its investment professionals in order to minimise the risk of loss and maximise the rate of return.

**Due diligence**

47. The University conducts due diligence on new and ongoing investments and investment service providers. Prior to the selection of an investment for the portfolio, effective due diligence, commensurate with the nature and characteristic of the investment, is undertaken. Further details are provided in the University’s Due Diligence Policy.

48. In managing investments and developing the Investment Governance Framework, the University has regard to the size, business mix and complexity of the University’s business operation.

**Currency hedging**

49. The Finance Committee will set the foreign currency hedge targets and limits based on its assessment of international economic environment. Further details are provided in the University’s Foreign Currency Policy.

**Use of derivatives**

50. Derivatives are financial instruments whose value and marketability are derived from the value of an underlying asset, liability or index which represents either the direct ownership of an asset or the direct obligation of an issue. Derivatives include financial instruments that trade on an organised exchange or “over-the-counter” (OTC) and which include, but are not limited to, futures, swaps, forwards, warrants and options. See Derivative Risk Management Policy.

51. Derivatives may be used to:

- Protect the value of an investment
- Protect the return on an investment
- Achieve an indirect exposure to a financial asset
- Achieve transactional efficiency
- Derivatives may not be used for speculation or leverage.
52. Derivatives are an integral part of the implementation of the investment strategy and may be used for, but not limited to:

- Hedging – to protect an asset or cash flow against fluctuations in market value or foreign currency exposures: and
- Transactional efficiency – a cost effective and practical means of implementing investment strategies or managing risks associated with the investment strategy.

53. Appropriate contracts (such as ISDA Master Agreements and an associated Credit Support Annex) must exist between the manager and counterparties.

54. “Non-over-the-counter” derivatives must be traded on an exchange which is a licensed central counterparty that guarantees the financial settlement obligations of the exchange traded contracts.

55. Derivatives will be valued using a mark-to-market methodology by the custodian. Revaluations will be undertaken on a regular basis. All derivative positions must be covered by collateral in the form of cash or cash equivalent.

56. Managers may be permitted to use derivatives consistent with the investment mandate given. These will be specified in the agreement with each appointed manager. The total market value of the mandate assets plus the total market exposure of the derivatives held must not exceed the total market value of the mandate portfolio. Leverage is not permitted.

57. Each manager granted the use of derivatives in the implantation of the mandate will provide the Fund with an audited Derivative Risk Statement on an annual basis. Each manager is required to provide the Fund with a copy of its current derivatives usage policy and to certify that the derivative exposures managed conform to their policy. Further details are provided in the University’s Derivative Risk Management Policy.

**Dynamic Asset Allocation (DAA)**

58. The Council, on advice, may also from time to time adopt a medium term asset allocation tilts within the portfolio.

59. DAA decisions would be based on expected returns and risks from each of the asset classes and undertaken with a view to reduce volatility or with the aim of capital preservation in the portfolio. These decisions will be consistent with the Fund achieving its long term investment objectives.

**Socially responsible investment**

60. The University directly manages a large investment portfolio. The aim of the portfolio is to deliver a balance of risk and return within parameters determined by the
University. Investment returns from the University’s investment portfolio support operational revenues, provide for payments on liabilities and underpin endowment mandates. In making these investment decisions, the University also considers its wider social responsibilities as an investor. To this end the University has formulated a Socially Responsible Investment Policy.

Strategy review

61. The Council will formally review the investment strategy at least annually to gauge whether the agreed investment objectives and investment strategies remain appropriate.

62. The results of the review will be reported with any recommendations for changes, if considered appropriate. Any decisions to adjust the investment strategy will have regard to the financial condition of the University. A detailed analysis setting out the rationale for the change and the expected impacts will be provided.

63. Short-term fluctuations in the financial markets should generally not require an adjustment in the investment objectives, although changes to the investment strategy may need to be made from time to time. The following criteria may be considered, among other things, to determine the need for a change in the investment strategy:

- Significant changes in the long term social, political or economic environment;
- New forms of investments arise that may be appropriate or the investment objectives are no longer expected to be met going forward;
- There is a material change in the: size, business mix and complexity of the University; risk profile of the Fund, or in the Fund’s underlying assets; liquidity profile of the Fund; or legislative or regulatory requirements.

64. Depending on timing and severity, events relating to the above list of criteria may require an interim review of the investment strategy, the need for which will be determined by the Council on a case by case basis.

Delegations relevant to this policy

- **346**: Buy, sell and subscribe for Cth Bonds and Treasury: Up to $250,000 for Student Managed Fund.
- **348**: Place/withdraw investments in negotiable certificates of deposit and interest-bearing bank deposits: Up to $500,000 for Student Managed Fund.
- **350**: Buy and sell accepted bank bills: Up to $500,000 for Student Managed Fund.
- **351**: Buy and sell listed fixed interest securities: Up to $250,000 for Student Managed Fund.
• 356: Buy, sell and subscribe for equity securities and options: Up to $500,000 for Student Managed Fund.

• 357: Buy, sell and subscribe units in property trusts listed on the Australian Stock Exchange: Up to $250,000 for Student Managed Fund.

• 448: Invest in Cash Management Trusts: Up to $750,000 for the Student Managed Fund.

• 449: Execute investment transactions (subject to investment policy & procedures).

• 450: Execute a term deposit (subject to investment policy & procedures).

• 362: Buy and sell investment property, subject to Finance Committee endorsement.

• 451: Execute management contracts, lease and other agreements in relation to the management of investment properties (subject to investment policy & procedures).

• 452: Authorise expenditure in relation to maintenance and capital improvements of investment properties within budget.

• 453: Appoint investment consultants.

• 454: Appoint fund managers, subject to endorsement by Finance Committee.

• 455: Appoint investment custodian.