

Tuvalu Trust Fund

Statement of Investment Objectives and Policy

Adopted on 26 May 2022

Contents

Statement of Investment Objectives and Policy.....	1
1. Introduction.....	2
2. Background.....	3
3. Governance.....	5
4. Investment beliefs.....	8
5. Investment strategy.....	9
6. Risk management.....	13
7. Review and monitoring procedures.....	14

Statement of Investment Objectives and Policy

Effective date

This Statement of Investment Objectives and Policy ('SIOP') takes effect from the date of approval by the Board, 26 May 2022.

Review date

This is the revised SIOP for the Tuvalu Trust Fund's assets and was adopted in 2022.

The date of the next annual SIOP review is November 2023 with a formal three-year review in November 2024 or sooner if policies, strategy or market conditions warrant.

1. Introduction

- 1.1 This Statement is to document the processes formulated by the Board (the “Board”) of the Tuvalu Trust Fund (the “TTF”) in relation to the investment of the TTF’s assets (the “Fund”), which are deemed to be investment assets and not operational assets.
- 1.2 This Statement has been compiled with the intent of facilitating all aspects of the on-going prudent and efficient management of the Fund’s investment arrangements. It describes the investment objectives and policies in detail, together with the procedures for monitoring and reviewing the investment managers.
- 1.3 In arriving at its investment objectives and its policy for achieving the objectives, the Board has obtained advice from the Investment Committee and the Implemented Consultant and has considered and agreed the various policy issues that are now incorporated as part of this SIOP.
- 1.4 That advice, the Board’s own considerations and decisions, and the subsequent selection of investments, have had regard to:
 - a) the nature and value of the investments (including their liquidity, marketability and diversity), and the risks associated with them;
 - b) the purposes for which the investments are held;
 - c) the issues affecting the investments and their value, including tax, costs and expenses, the potential for capital appreciation or depreciation, appreciation or depreciation of the value of the currency of investment, income, and the incidence of these issues;
 - d) the term of the investments, and the suitability of this given b) above;
 - e) the impact of inflation and the desirability of maintaining the capital value of the investments.
- 1.5 These objectives and policies will be reviewed and changed as appropriate, to reflect changing capital markets, government regulations and the TTF’s requirements.
- 1.6 The Board has appointed an Investment Committee to undertake the tasks and responsibilities set out in section 2.10. The committee comprises at least three members, a representative for the New Zealand Board member, one for the Australian Board member, and one for the Tuvaluan Board member, with the TTF’s Secretariat being the secretary. The Investment Committee rules and responsibilities are detailed in the TTF Investment Committee Charter.
- 1.7 The Board and/or the Investment Committee shall have the power to delegate to the Implemented Consultant such of its tasks and responsibilities as it prudently deems appropriate to carry out the duties and responsibilities set out in this statement.

2 Background

The Tuvalu Trust Fund was established for the purpose of contributing to the long-term financial viability of the Government of Tuvalu by providing an alternative and sustainable source of revenue to help support its recurrent budget. Further to this, it was envisaged that such support should allow the Government of Tuvalu to improve and develop its social and economic infrastructure and services. In addition, it was also intended that the Trust Fund would enable the Government of Tuvalu to better manage and utilise external capital assistance.

The underlying investment objective for TTF is to maintain in real (inflation adjusted) terms the original capital value of the assets as well as any subsequent capital additions. It is also a primary objective that the capital value of the TTF assets remains intact, with any drawdowns by the Government of Tuvalu being funded from the margin of outperformance by the investment managers over the maintained real value.

The TTF was established in July 1987 with a capital base of \$26 million. Subsequent additional contributions have exceeded twice this sum.

The Maintained Value of the Fund is defined as the sum of all capital contributions made to the TTF, indexed by Australian CPI (All Groups).

The Market Value of the Fund is defined as the net of buy-sell spread costs, management fees and tax, value of the units held by the underlying fund managers and the cash in the Fund's bank account.

The base currency for measurement of values and reporting is Australian dollars.

General investment objectives

2.1 The Board's general investment objectives for the TTF are as follows:

- To invest the Fund as permitted by law.
- To prudently manage all aspects of risk in relation the Fund, including ensuring:
 1. the assets are adequately diversified;
 2. the assets have an appropriate level of liquidity; and
 3. that any party to whom investment decision making is delegated exercises integrity, prudence and professional skill in fulfilling the investment tasks delegated to them, and that the actions of the party are fully accountable to the Board.

Specific investment objectives

2.2 The investment objective of the Fund is to grow the real value of the original capital and subsequent contributions, while maximising the returns available to the Government of Tuvalu over the long term, subject to an appropriate level of risk being taken.

The Board has determined that this objective can best be achieved by investing 65% of the portfolio in growth assets and 35% of the portfolio in income assets.

Since its inception, the Fund's target investment return has been 4.5% p.a. above inflation after fees. This remains its long-term target, however, given current market conditions and based on the most recent capital market assumptions provided by the Implemented Consultant, the Fund is expected to provide a return that is 3.9% p.a. in excess of inflation over the next 10 years, with the likelihood of a negative return 1 year in every 4.5.

The Government of Tuvalu has set an aspirational target of growing the Fund to \$1 billion maintained value by 2030 through additional capital contributions or reinvestment of sums available for distribution, as the budgetary and cash flow requirements of the Government of Tuvalu permit.

Based on the most recent capital market assumptions, the Fund would need to be fully invested in growth assets, receive additional contributions of approximately \$50m per year and reinvest all distributions in order to meet the \$1bn target by 2030.

Alternatively, if the current investment strategy is retained, all distributions are reinvested, and annual contributions of \$2m per year are received (consistent with the historic average), the \$1bn target could be expected to be achieved by 2044.

3. Governance

The Board's powers and discretions are defined in the Tuvalu Trust Fund deed ('Agreement concerning an international trust fund for Tuvalu'). All powers of the fund have been vested in and are exercisable by the Board, including:

1. The operation, supervision and management of the funds;
2. The investment and distribution of resources; and
3. All necessary authorities

The Board has adopted a governance structure to manage and monitor the fund on an ongoing basis. It may revisit governance arrangements from time-to-time. The key responsibilities of each party in the governance structure are laid out below.

Board of directors

3.1 Governance

- (i) Appointing and regularly reviewing all external parties identified in this SIOF, including an ongoing review of their responsibilities.
- (ii) Reviewing this SIOF on a regular basis.
- (iii) Arranging for the publication of an annual report detailing the activities and management of the fund within six months of the end of the financial year.

3.2 Investments

- (i) Setting and periodically reviewing the Fund's investment beliefs (philosophy).
- (ii) Determining and periodically reviewing the strategic asset allocation.
- (iii) Setting and periodically reviewing the Fund's responsible investments policy.
- (iv) Setting and periodically reviewing the Fund's foreign currency strategy.
- (v) Determining and periodically reviewing the fundamental strategy (such as active or passive management) to be used for each asset class.
- (vi) Establishing and periodically reviewing the risk management policies (including the rebalancing policy/ranges and the liquidity policy), and the review and monitoring procedures.
- (vii) Establishing criteria for the measurement of the performance of the Fund's assets.
- (viii) Selecting an implemented consultant to oversee the implementation of the fund, including the selection, management and monitoring of any underlying fund managers.
- (ix) Regularly reviewing the investment objectives and constraints.
- (x) Reviewing and approving any dynamic asset allocation recommendations made by the Investment Committee.
- (xi) Regularly monitoring the investment results to determine whether the implemented consultant has performed satisfactorily relative to their objectives.
- (xii) Performing such audits of the processes and controls of the implemented consultant appointed as it feels is necessary to obtain assurance that the assets are being managed appropriately.

Investment Committee

3.3. Governance

- (i) The Investment Committee shall be governed by the Investment Committee Charter, as adopted by the Board on 26 May 2022.

- (ii) They shall be responsible for reporting to the Board on all significant investment related activities in the inter-board meeting period.

3.4 Investments

- (i) To manage the relationship with, and monitor the performance of, the Implemented Consultant on an ongoing basis.
- (ii) To monitor the performance of the Fund and report to the Board regularly.
- (iii) To liaise with the Implemented Consultant in regard to any non-performance issues and report to the Board regularly.
- (iv) To review any dynamic asset allocation advice as provided by the Implemented Consultant and to recommend to the Board to approve the implementation of any purposeful shifts away from the Strategic Asset Allocation as defined in Section 5.3.
- (v) To review the Implemented Consultant's report and ensure on its ability to carry out the roles as detailed in the SIOp.
 - 1 To keep under review the provisions of the SIOp and to recommend amendments as appropriate.
 - 2 To keep under review the investment strategy of the Fund and report to the Board on any recommended changes.
 - 3 To investigate any specific issues raised by the Board.
 - 4 To attend Board Meetings.

Implemented Consultant

3.5 Governance

- (i) Participating with the Investment Committee in the regular review of this SIOp.

3.6 Investments

- (i) Advising the Board on all matters contained in the 'Investments' section of clause 3.2 above.
- (ii) Offering funds for each applicable asset class, consistent with the fundamental strategy, and the foreign currency hedging policies determined by the Board.
- (iii) Maintaining the actual asset allocation within the specified rebalancing ranges in accordance with the rebalancing policies set out in the SIOp.
- (iv) Providing the Board with quarterly reports relating to the Fund's investment performance.
- (v) Advising the Board of any market developments or best practice changes that may affect the way that the Fund's assets are or should reasonably be invested.
- (vi) Providing the Board and Investment Committee with advice on other relevant investment issues.
- (vii) Managing the total portfolio in accordance with the objectives, constraints and policies of the TTF.
- (viii) Providing the Investment Committee with any dynamic asset allocation advice.

Secretariat

3.7 Investments

- (i) To calculate, record and disseminate to relevant parties the Maintained Value of the TTF.
- (ii) To act as Secretary for the Investment Committee which involves coordination on meeting arrangements, distribution of all materials, producing minutes of meetings and ensuring that matters requiring action are acted upon in a timely manner.

- (iii) To provide a facilitating role between the various parties including the Investment Committee, Implemented Consultant and the TTF Board of Directors.
- (iv) To assist the Implemented Consultant with provision of relevant information and any other documents necessary to allow it to fulfil its role.
- (vii) On a timely basis, to prepare annual budgets, maintain accounting records, prepare financial accounts, report actual costs against the annual budget, coordinate the annual audit and submit audited financial statements of the TTF to the Board for approval.

4. Investment beliefs

The Board and Investment Committee have formulated a mutually agreed set of investment beliefs:

TOPIC	BELIEF	IMPLICATIONS FOR FUND
Risk	There can be reward for investment risk. Investors are generally compensated for accepting higher risk, or increased volatility of returns, by realising higher long-term returns.	Diversification improves the risk to return trade-off for the Fund. It allows the Fund to generate higher returns for the same level of risk or reduce risk for the same level of returns.
Diversification	Prudent diversification of assets, both between and within asset classes, will reduce volatility of total portfolio returns.	Since the Fund has a long-term horizon, it is less affected by short-term volatility, so it can afford to take on additional risk with the aim of achieving higher returns.
Timeframe	Investors with a long-term horizon can outperform investors with a shorter-term orientation.	
Asset Allocation	Asset allocation is the key determinant of long-term risk and return.	
Active Management	Active management (versus passive) can return a premium over time to market returns but requires skill. Opportunities to add value through active management are not uniformly distributed across asset classes or through time.	The Fund may use both active and passive management within its investment portfolio.
Governance	Governance matters. Robust structures, clear accountabilities and sound advice contribute to the fund's performance. The Board's role is strategic, including oversight of the Fund's management.	When taking strategic decisions, the Fund benefits from having a diversity of views on the Board and on the Investment Committee.
Costs	Fees, taxes and other transactions costs all affect returns. In order to minimise their potential impact, these factors need to be understood, measured and managed.	Costs matter. Efficient implementation can lower costs and contribute to higher returns.
Responsible Investment	The integration of environmental, social and governance factors into investment decision-making can help to identify opportunities and risks, improving performance. Through responsible investment decisions, the Fund can also reflect and support its beneficiaries' values and circumstances.	Tuvalu is particularly susceptible to the adverse impacts of climate change and it is appropriate to reflect this in the investment strategy.

5. Investment strategy

The Board sets the investment strategy based on the investment beliefs in Section 4 and on the Fund's investment objectives in Section 2.

5.1 Asset classes

The Fund comprises, in varying proportions, the following asset classes:

- Australian equities
- International equities (developed)
- Global small cap equities
- Emerging markets equities
- Australian listed property securities
- International listed property securities
- Global listed infrastructure
- Global absolute return bonds
- Global high yield bonds
- Australian sovereign bonds
- Australian inflation plus bonds
- Global credit
- Australian cash

The Board will review the suitability of the above asset classes from time to time.

5.2 Asset class benchmarks

The Board, with advice from the Investment Committee, has adopted the following benchmarks for the asset classes detailed:

ASSET CLASS	BENCHMARK
Australian equities	S&P/ASX 300 (TR)
International equities (developed)	MSCI World ex Australia (NR) – 50% AUD hedged
Global small cap equities	MSCI World Small Cap
Emerging markets equities	MSCI Emerging Markets (Net) Index
Australian listed property securities	S&P/ASX200 Property Trusts Accumulation Index
International listed property securities	FTSE EPRA/NAREIT Developed Index AUD hedged
Global listed infrastructure	FTSE Global Core Infrastructure 50/50 100% AUD hedged
Global absolute return bonds	Bloomberg AusBond Bank Bill Index + 1%
Global high yield bonds	ICE BoAML BB-B Rated Developed Markets High Yield Constrained Yield
Australian sovereign bonds	Bloomberg AusBond Treasury Index
Australian inflation plus bonds	Lagged CPI+1%
Global credit	60% Barclays Global Aggregate – Corporate Index and 40% Barclays Global Aggregate – ex Treasuries, ex Government Related Index (AUD hedged)

ASSET CLASS	BENCHMARK
Australian cash	Bloomberg AusBond Bank Bill

5.3 Strategic asset allocation

The current strategic asset allocation, rebalancing ranges and dynamic asset allocation ranges are set out in the table below and were agreed by the Board in 26 May 2022.

FUND	WEIGHT	REBALANCING RANGES	DYNAMIC ASSET ALLOCATION RANGES
Mercer Australian Shares Fund	12%	+/-3%	0% to 20%
Mercer Passive Australian Shares Fund	12%	+/-3%	0% to 20%
Mercer International Shares Fund (UH)	5%	+/-2%	0% to 20%
Mercer Passive International Shares Fund (UH)	5%	+/-2%	0% to 20%
Mercer Hedged International Shares Fund	5%	+/-2%	0% to 20%
Mercer Passive Hedged International Shares Fund	5%	+/-2%	0% to 20%
Mercer Global Small Companies Shares Fund (UH)	4%	+/-2%	0% to 10%
Mercer Emerging Markets Shares Fund (UH)	5%	+/-2%	0% to 10%
Mercer Passive Global Listed Infrastructure Fund (H)	6%	+/-2%	0% to 15%
Mercer Passive Australian Listed Property Fund (H)	3%	+/-2%	0% to 15%
Mercer Passive Global Listed Property Fund (H)	3%	+/-2%	0% to 15%
Total Growth Assets	65%	+/- 5%	40% to 80%
Mercer Global Absolute Return Bond Fund (H)	7.5%	+/-2%	0% to 15%
Mercer Global High Yield Bond Fund (H)	2.5%	+/-2%	0% to 15%
Mercer Australian Sovereign Bond Fund	5%	+/-2%	0% to 15%
Mercer Australian Inflation Plus Fund	10%	+/- 2%	0% to 15%
Mercer Global Credit Fund (H)	5%	+/-2%	0% to 15%
Mercer Cash Fund – Term Deposit Units	5%	+/-2%	0% to 20%
Total Income Assets	35%	+/- 5%	20% to 60%

For funds with foreign currency exposure, (H) signifies a fully hedged fund while (UH) signifies a fully unhedged fund

5.4 Rebalancing

It is recognised that, as a result of market movements and cash flows, the Fund's asset allocation will deviate from the strategic policy. The Board has agreed rebalancing ranges so that the strategic asset allocation will be broadly maintained but without incurring excessive transaction costs. The Implemented Consultant will monitor the Fund on a monthly basis (or in the event of a significant market event, more frequently) and, in the event of a breach of these ranges, will instruct the custodian to make the necessary transactions to bring the breached exposure(s) to approximately the

policy weight(s) within 7 business days. The Implemented Consultant will work with the Secretariat to understand any expected cashflow before instructing the custodian to undertake the required transactions. The Implemented Consultant will report to the Investment Committee any rebalancing activity that has been undertaken.

5.5 Foreign currency strategy

The Board's policy is to fully hedge foreign currency exposures in asset classes where foreign currency exposure adds unnecessary volatility to the returns in that particular asset class. In particular, global fixed interest exposures and listed property and infrastructure are fully hedged while small cap global companies and emerging markets equities are unhedged. Strategically, developed international equities are hedged to 50% but dynamic asset allocation positions can be taken that deviate from this strategic hedge ratio of 50%. On a quarterly basis, the Implemented Consultant will confirm that there have been no deviations in the hedging of foreign currency exposures within any of the funds outlined in the table in Clause 5.3.

5.6 Taxation

The TTF's investment income is not subject to taxation in Australia or Tuvalu. The Investment Committee has recognised the effect of this status in forming and recommending the investment objectives and policy.

5.7 Responsible Investment

The TTF is an intergenerational investor and therefore takes a long-term approach to investing. The Board believes that investing responsibly leads to better long-term outcomes for the TTF and for its beneficiaries.

Environmental, Social and Governance considerations

The Board believes that the integration of environmental, social and governance (ESG) factors into investment decision-making can help to identify opportunities and risks, improving performance. The Board will therefore require the Fund's investment managers to incorporate ESG considerations into their investment processes and will receive regular reporting on these considerations from the investment managers.

The Board will also require the investment managers to be signatories to the United Nations-supported Principles for Responsible Investment.

Climate change

The Board also believes that, through responsible investment decisions, the Fund can reflect and support its beneficiaries' values and circumstances.

The Board of the TTF has a fiduciary duty to act in the best interests of the Fund's beneficiaries, including future generations of Tuvaluans. While 'best interests' typically means financial interests, i.e. maximising returns on the Fund while taking an appropriate amount of risk, the Board believes that they also have a responsibility to ensure that the activities of the companies that the Fund invests in do not negatively impact beneficiaries. Since Tuvalu is particularly susceptible to the adverse impacts of climate change, the Board is committed to minimising the Fund's exposure to fossil fuel reserves and carbon emissions, to the extent that it is possible to do so.

Exclusions

In order to avoid reputational risk to the TTF, the Board expects the Implemented Consultant and any appointed investment manager to avoid investing in companies which are involved in the manufacture of controversial weapons (such as cluster munitions, anti-personnel mines and nuclear weaponry) and those involved in the manufacture of tobacco.

Active ownership

The Board expects the Implemented Consultant and the appointed investment managers to exercise their voting rights and to use their influence as shareholders to encourage companies to manage ESG risks. The Implemented Consultant is also expected to provide regular updates to the Board on their voting record.

Ongoing review

The Board acknowledges that responsible investment is an evolving area and is committed to ongoing engagement and review. It will continue to evolve its policies and procedures over time with the aim of ensuring its values and those of the people of Tuvalu are reflected in the TTF investments.

5.8 Dynamic asset allocation

The Investment Committee and Board acknowledge there are extreme market movements that can create opportunities and present risks. As outlined within the SIOP, the Board, with rationale and recommendation from the Investment Committee and Implemented Consultant may temporarily shift away from the strategic asset allocation in periods of extreme market mispricings. These shifts must not exceed the dynamic asset allocation ranges specified in the table in Clause 5.3.

5.9 Active versus passive management

As noted in 4. Investment beliefs, the Board and Investment Committee believe that active management (versus passive) can return a premium over time to market returns but requires skill. Opportunities to add value through active management are not uniformly distributed across asset classes or through time, therefore the Fund may use both active and passive management within its investment portfolio.

6. Risk management

6.1 Gearing

The Fund does not borrow at a total portfolio level. Gearing may, however, be permitted within individual investment management mandates for the purposes of efficient portfolio management only.

6.2 Lending and credit

The assets of the Fund are not to be used for the purposes of lending nor for backing the credit position of other parties.

6.3 Diversification

An appropriate level of diversification across securities, sectors, asset classes and countries will be maintained.

6.4 Liquidity

Liquidity will be considered and maintained at an appropriate level in accordance with the Fund's liquidity policy.

7. Review and monitoring procedures

7.1 SIOF

The SIOF will be reviewed no less frequently than annually, or sooner if appropriate due to events including but not limited to material changes in investment strategy, the Fund's governance model, the parties included in this SIOF, or market conditions.

Any changes to the SIOF must be approved via resolution by the Board.

7.2 Investment strategy

The strategic asset allocation is to be reviewed, in principle, every three years, or more frequently if there are significant changes to the economic and commercial environment, or as the Board sees fit.

7.3 Performance report

The Implemented Consultant will prepare a performance report for the attention of the Investment Committee and discussion at a meeting shortly after each financial quarter-end.