Plenary Funds Management

Hedging Policy

Document Details

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1. Table of Contents

2. Introduction

Executive Summary

This Hedging Policy (the "**Policy**") establishes guidelines for how debt and currency related risks are to be managed. It provides guidance on appropriate hedging instruments and specifies acceptable risk exposures.

Purpose

To provide clear principles and guidance on how debt and currency related risks are to be assessed and appropriately managed across Plenary Funds Management Pty Ltd ("**PFM**")'s funds and separately managed accounts ("**SMA**"). This includes detail on risk / exposure tolerances as well as appropriate hedging instruments.

Scope

This policy applies to all PFM funds and SMAs.

3. Rationale

The Policy has been developed by PFM to protect its funds and SMAs from market volatility in order to minimise valuation, distribution, and other impacts. Typically, the volatility being minimised pertains to cost and availability of debt, interest rates including base rate and margin, and foreign exchange ("**FX**") exposure. This Policy and the guidelines herein remain subject to the governing documents of the funds and SMAs managed by PFM.

This Policy does not address underlying asset / SPV level exposures, whose management is subject to the policies of the asset's board.

4. General Information

Approach

Managing debt, interest rate and currency risk involves three stages:

1. Identification of exposures;
2. Quantification of exposures; and
3. Risk management response

Authorised Instruments

The PFM Investment Committee ("**IC**") has approved the instruments detailed below.

Approved Debt Instruments

- Senior loan facilities;
- Mezzanine loan facilities;
- Subordinated loan facilities;
- Bonds;
- Notes; and
- Other such instruments as approved by the IC from time to time

Approved Hedging Instruments

- FX contracts (forwards and spot);
- Interest rate swaps and forward interest rate swaps;
- Currency swaps;
- Currency options; and
- Other such instruments as approved by the IC from time to time

Guiding Principles

Debt Risk

Debt should be structured having regard for the following:

- Ensuring no recourse beyond the fund or SMA;
- Additional capital requirements should be sourced from capital within the fund or SMA itself; and
- No guarantees or undertakings (or similar instruments) from PFM or other PFM corporate entities.

Base Interest Rate Risk

Long term base interest rate risk may be managed by exchanging floating rate exposure for fixed rate exposure. Fixed rate exposure can be via a defined fixed rate or a known worst case interest rate (or similar).

FX Risk

FX risks are managed through FX forward contracts, or similar instruments that replicate the same effective hedge.

Reporting

At least annually PFM table the hedging strategy pertaining to each fund and/or SMA at the IC. The hedging strategy will take account of the:

- relevant governing documents or mandate;
- identification of the current and expected exposure;
- quantification of the current and expected exposure; and,
- make strategic recommendations to manage the risk.

Debt and derivative exposures as well as any other material relevant matters will be reported to the PFM Board at least quarterly.

5. Debt Risk Management

The following guidelines apply in respect of:

- New debt facilities;
- Variations to existing facilities (including refinance, extension or cancellation); and
- Other matters as they pertain to the risks associated with the cost and availability of debt.

Guidelines

Collateral / Security

Underlying assets can be used to secure debt funding on a non-recourse basis. Uncalled committed capital (e.g. fund commitment queue) may also be used but the exposure of investors is limited to their capital commitment.

Portfolio Gearing

Fund and SMA gearing should be as prescribed by the relevant governing documents, noting that the mandate and risk profiles differ necessitating different levels of gearing.

6. Base Interest Rate Risk Management

The operations of PFM may give rise to the following interest rate risks:

- **Market / Outright risk** - the impact on interest expense due to movement in interest rates
- **Basis risk** - the risk of an inconsistent movement between the value of the hedge and the underlying exposure
- **Re-pricing risk** - the risk of incurring a higher interest expense due to inconsistent repricing between the hedge instrument and underlying exposure

Approach

Interest rate hedging may be conducted by hedging base rate exposure at the fund / SMA level (e.g. fund / SMA level debt facility), subject to the governing documents of the fund or SMA.

Risk Parameters

The risk parameters include:

- Value-at-Risk ("**VaR**") ratio limit;
- Hedge ratio limits; and
- Term to maturity / duration target range.

VaR Ratio Limit

VaR ratio limits vary depending on the fund or SMA. They are intended to reflect the maximum acceptable risk threshold and are considered together with the impacts of interest rate movements.

For funds and SMAs the parameters, which remain subject to the governing documents, are as follows:

- Sufficient interest rate hedges to ensure that the 12 month forecast distributions of the fund / SMA varies by no more than 10% as a result of interest rate exposures, with a 95% degree of confidence; and
- Hedges of no more than 100% and not less than 50% of floating interest rate exposure over a 12 month forecast period.

Hedge Ratio Limits

Maximum hedge ratio limit of 100% and minimum of 50% of total projected debt in any 12 month forecast period (in accordance with the VaR ratio limit). Where debt is expected to be repaid within 12 months, no minimum limit will apply.

Term to Maturity / Duration Target Range

The concepts of term to maturity and duration are explained below:

- **Term to Maturity** - Weighted average term to maturity of the debt portfolio or exposure and hedging instruments
- **Duration** - Sensitivity of the present value of the combined debt portfolio and corresponding hedging instruments with respect to a change in interest rates

The term to maturity / duration target range is intended to be a range of hedge duration aligned to the fund or SMA's objectives.

7. FX Risk Management

There are two main risks associated with currency movements:

1) **Transaction risk** – the risk that offshore cashflows repatriated to another country will vary in that other country's dollar terms (target currency) due to movements in the value of the target currency against the currency in which they are earned (e.g. distributions)

2) **Translation risk** – the risk that the equity value of an asset will fluctuate as a result of movements in the value of the target currency as foreign assets are converted into the target currency in the consolidated accounts of funds and SMAs

Transaction Risk

FX hedging may be undertaken in respect of forecast foreign currency income net of foreign currency expenses. PFM can hedge up to 100% of forecast foreign currency income over a 12 month forecast period.

Translation Risk

The following are key determinants of whether to hedge translation risk:

- The volatility of the currency involved;
- The volatility of the cashflows generated by the investment;
- The cost of hedging; and
- The size of the risk in the context of the total Net Asset Value ("**NAV**") of the portfolio.

FX hedging shall be undertaken between currencies as required by the given fund or SMA.

Approach

As a general rule, all PFM portfolios should consider placing an FX hedge sized to 100% of the equity value of the FX exposed assets upon acquisition and at each semi-annual valuation. A hedge effectiveness range of 95 – 105% should be maintained at all times, and where this is no longer the case the hedge should be adjusted.

Consideration should also be given to whether a transaction risk hedge is appropriate.

8. Reporting and Counterparty Risk Management

At least annually PFM will review the hedging strategy pertaining to each fund and/or SMA. It will then be provided to the IC for their consideration and approval. Ongoing compliance checks will be conducted against the strategy and this Policy.

PFM will maintain a register of all exposures for all debt and currency hedging across its funds and SMAs. These exposures, as well as any other material relevant matters, will be reported to the PFM Board at least quarterly. As part of the register, PFM will quantify the level of exposure to each counterparty and will from time to time, and at least annually as part of the hedging strategy approval evaluate the risks associated with each counterparty.

9. Supporting Policies and Documents

This Policy is intended to operate alongside existing RE policies. To the extent that there is an inconsistency between this Policy and that of an RE, the RE's policy will prevail.

This Policy is intended to operate alongside relevant governing document(s). To the extent that there is an inconsistency between this Policy and that of a relevant governing document(s), the relevant governing document(s) will prevail.

10. Review and Assessment

The Head of Funds Management of PFM will coordinate the review of this Policy by the IC at least annually to ensure that it remains current and compliant with all applicable laws governing PFM's relevant activities and functions including obtaining approval from the relevant stakeholders and Board.