

## Robeco Hong Kong Limited Derivative Risk Management Statement - Part B

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### 1. Responsible Party Name

This Derivative Risk Management Statement (“**DRMS – part B**”) has been prepared by Robeco Hong Kong Limited (“**Robeco HK**”) as investment manager of:

- Australian domiciled managed investment schemes for which Robeco HK is the investment manager and EQT is the Responsible Entity (collectively referred to throughout this document as “**Australian Funds**”); and
- Discretionary accounts (“**Mandates**”) for institutional clients including those Mandates for which the day-to-day investment management activities are delegated to Robeco Institutional Asset Management B.V. (“**RIAM**”)

The Australian Funds may invest in Luxembourg domiciled Robeco funds managed by affiliated entities of Robeco HK (“**Underlying Funds**”). In this DRMS – Part B, the Australian Funds and the Underlying Funds are collectively referred to as “**Funds**”. Robeco HK and RIAM are collectively referred to throughout this DRMS – Part B as “**Robeco**”.

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### 2. The Objective of this DRMS – part B

The objective of this DRMS – part B is to give a summary of the policies and processes in place to ensure the appropriate use of derivatives. This DRMS – part B also outlines the risk associated with the use of derivatives and the control framework which has been developed to manage these risks, maintain legal compliance and substantiate statements made in disclosure documents. In the view of Robeco, the use of derivatives should not be considered in isolation, but as part of the investment strategy of the Fund/Mandate as a whole.

This DRMS – part B will be reviewed and updated where appropriate by the management of Robeco HK on a regular basis.

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### 3. Definition of Derivatives

A derivative is defined as: “a financial asset or liability whose value depends upon, or is derived from, other assets, liabilities or indices”.

Derivatives include, but are not limited to:

- Exchange traded future contracts, options, warrants and options on futures; and
  - Over the Counter (“**OTC**”) contracts, including forward rate agreements, options, swaps (including credit default and total return swaps) and contracts for difference.
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### 4. Relationship to investment strategy of the Funds/Mandates

The assets of each Fund (including derivatives) are managed in accordance with the investment strategy specifically tailored for the product’s objective. The investment strategy of the Funds will be set out in the relevant trust deeds, constitutions, articles of association or offer documents (including prospectuses or Product Disclosure Statements that are provided to potential investors). Collectively referred to as “**Governing Documents**”.

Robeco seeks to maximize returns within acceptable levels of risk, in accordance with the investment strategy of Funds. This DRMS – part B should, therefore, be read in conjunction with the Governing Documents for the Funds being managed.

The assets of each Mandate are managed in accordance with the investment responsibilities and restrictions agreed upon in the Investment Management Agreement or other written agreement (“**IMA**”) between the institutional client and Robeco HK.

Derivatives should not be viewed as a separate asset class but must be consistent with the investment objectives and strategy of the particular Fund/Mandate. Where derivatives are permitted as authorized investments, they are managed in a way that is consistent with and subordinate to the investment strategy or IMA, as applicable.

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## **5. Purpose of the use of Derivatives**

Robeco considers the use of derivatives as appropriate in managing investment as and believes derivatives can provide value to the investment process. Derivatives may be used for a variety of purposes, including (but not limited to) the following:

### *Risk management*

- to hedge an asset of portfolio against fluctuations in market or currency values;
- to control the impact on portfolio valuations of market movements caused by transactions.

### *Transactional efficiency*

- to reduce transaction costs;
- to control the impact of significant transactions on portfolio valuations;
- to adjust asset exposures within defined parameters

### *Value added strategies*

- to manage currency exposures;
  - to extract preferred components of security value.
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## **6. Restrictions on the use of derivatives**

### **6.1 Internal policies**

Robeco will use derivatives if their use is permitted within the strategy, objectives and constraints by the Governing Documents or IMA, as applicable. Robeco translates constraints on the use of derivatives in legislation and regulations and the Governing Documents or IMA in management guidelines and limits for each Fund/Mandate. This allows efficient implementation in accordance with the risk management practices detailed in the following sections. A list of approved instruments is maintained and updated regularly.

The portfolio manager is required to make investment decisions for the applicable Fund that are consistent with the strategy and management guidelines and must adhere to the limits regarding the use of derivatives.

Robeco devotes resources to maintain and configure computer systems to assist in management of investment restrictions, including the use of derivatives.

## 6.2 Client restrictions

Clients may limit derivative usage beyond this DRMS – part B via restrictive conditions in the IMA or other written agreement between the institutional client and Robeco HK. Mandate management procedures are then extended to capture any additional limits.

## 7. Risk analysis

The use of derivatives in a Fund gives rise to various types of risk, of which some are not necessarily peculiar to derivatives. The primary types of risk include market risk, liquidity risk, counterparty risk and operations risk. Robeco emphasizes the interconnection of the above mentioned risk types. Especially in stressed markets, the mentioned types of risk tend to reinforce each other. The mentioned types of risks and the processes to monitor them are described below.

### 7.1 Market risk

Market risk is the risk of adverse movements in markets (including asset prices, volatility, changes in the yield curve or other market variables) for the derivatives or the underlying assets, reference rate or index to which the derivative relates. Such risk is created by holding any security, physical or derivative, which creates exposure to movements in prices of a security but in particular, derivatives give rise to the risk that the value of the derivative(s) used may not move in line with the underlying asset(s) value (basis risk).

The following measures are in place to monitor and control market risk:

- For each Fund/Mandate, the investment strategy, management guidelines and limits are specified. Portfolio managers manage the total portfolio exposures of the applicable Fund/Mandate in line with these guidelines and limits. Robeco Risk Management and Robeco Compliance monitor the adherence to these guidelines and limits.
- The primary risk monitoring standard for a Fund/Mandate is either a tracking error or a value-at-risk ratio approach. For Funds/Mandates that uses a benchmark for portfolio construction, the tracking error is used for market risk monitoring. For Funds/Mandates that do not use a benchmark for portfolio construction, the value-at-risk ratio approach is used to monitor market risk.
- For all Funds/Mandates, the net market exposure (absolute sum of long equity exposure -/- absolute sum of short equity exposure) is monitored and compared to the applicable limit of the applicable Fund/Mandate.
- For all Funds/Mandates the gross market exposure (absolute sum of long equity exposure + absolute sum of short equity exposure) is monitored and compared to the applicable limit of the applicable Fund/Mandate.
- For all Funds/Mandates, the issuer exposure is monitored since this risk factor contains idiosyncratic risk and captures event risk. The outcome of this monitoring is compared to the applicable issue limits of the applicable Fund/Mandate.

#### *Stress tests*

Stress tests, being a combination of simple sensitivity tests and historical scenarios are a complementary measure to the above described controls. Stress tests are executed on a regular basis to monitor how the applicable Fund/Mandate behave under extreme market circumstances.

### 7.2 Liquidity risk

Two types of liquidity risk rise from investing in derivatives, market liquidity risk and funding liquidity risk. Market liquidity risk is the risk that a responsible party may not be able to, or cannot easily, unwind or offset a particular derivative position at or near the previous market price due to inadequate market depth or disruptions in the market place. Funding liquidity is the risk that a responsible party may not be able to meet the future financial obligations from its derivative activities such as meeting margin calls on futures contracts.

The measures in place to control and mitigate liquidity risk:

- Portfolio managers manage the levels of liquidity maintained in the Funds/Mandates. Robeco Risk Management and Robeco Compliance monitor these liquidity levels;
- Portfolio managers monitor movements in derivatives to ensure that margin calls can be met;

- Portfolio managers monitor the degree of liquidity for derivatives to ensure that these can, if needed, be converted to cash within an acceptable timeframes and at reasonable prices.

### 7.3 Counterparty risk

Counterparty risk is the risk that a counterparty will fail to perform its contractual obligations under a derivatives contract. Robeco has the following controls and measures in place to monitor and mitigate counterparty risk:

#### *Concentration controls*

For each Fund, concentration controls are in place that restrict exposures per counterparty and ensure diversification and thus limit the financial impact of the default of a single counterparty on a portfolio. In case that concentration limits are described in the IMA, these will be adhered to.

#### *Counterparty selection*

- The key control in managing counterparty risk is the counterparty selection process, executed in accordance with the Robeco counterparty risk policy or IMA.
- In order for a new counterparty to be added to the Robeco approved counterparty list, it needs to pass a rigorous acceptance procedure; new counterparties are analyzed on a wide set of criteria as e.g.: issuer rating, credit spread, adverse share price movements, excessive volatility, financial statements, company news. For existing counterparties, these controls are checked on a daily basis.
- In case the issuer rating of counterparty falls below the level that is accepted by Robeco, this finding will be escalated to the appropriate risk management committee in Robeco which decides on appropriate measures.
- The other factors enable Robeco to signal the potential deteriorating creditworthiness of the counterparty. Breaches of these controls will generally give rise to discussions with the portfolio manager, credit analysts of the Treasury department and might lead to reducing exposures.

#### *Collateral and contracts*

- Where possible, counterparty risk is mitigated through the use of collateral and contingency planning. For almost all OTC derivatives, ISDA agreements allow for netting of counterparty risk and Credit Support Annexes (CSAs) define the details (frequency, haircuts, minimum transfer amount etc.) of the exchange of collateral between counterparties. For OTC derivatives, Robeco receive cash collateral.
- Cash sent to clearing brokers is not always fully segregated. To mitigate this direct credit risk, Robeco has secondary clearing brokers in place to the extent that this is practically possible.
- Robeco adopts central clearing for OTC derivatives as much as possible. From a counterparty risk perspective, central clearing significantly reduces counterparty risk.

#### *Handling a default*

- Robeco has detailed scripts available that carefully describe all steps in the process of handling a default of a counterparty.

### 7.4 Operational risk

Operational risk is the risk that deficiencies in the effectiveness and accuracy of the information systems or internal controls will result in a material loss. This risk is associated with human error, system failures and inadequate procedures and internal management controls. This might include the risk that the valuation system incorrectly calculates a price for a derivative or its equivalent exposure.

#### *Organizational setup*

- Organizational and reporting structures ensure the separation of functions between investment management and investment administration to ensure proper segregation of duties.
- Monitoring (such as limits monitoring) are performed and managed independently of the portfolio managers teams. These functions have independent lines of reporting.
- Several governing committees are in place to ensure comprehensive and consistent risk oversight throughout the different entities within Robeco.

## *Responsibilities*

Robeco uses a “three lines of defense model” for the day-to-day responsibilities for risk management

- Portfolio managers and operational managers “own” and manage risk. They are responsible for maintaining effective internal controls and executing risk and control procedures on a daily basis. These procedures are designed to keep the levels of portfolio risk consistent with the strategy, management guidelines and limits for each Fund/Mandate. This is the first line of defense.
- Robeco Risk Management and Robeco Compliance are responsible for risk oversight, the second line of defense. The risk management and compliance functions help to build proper controls and monitor the first line of defense control. The monitoring process includes checks to ensure that controls are being maintained and adhered to. Any breaches of limits or other restrictions are notified to the portfolio managers and escalated to the appropriate levels within Robeco.
- Robeco internal audit acts as the third line of defense by providing assurance on the effectiveness of governance, risk management and internal controls including the manner in which the first and second lines of defense achieve risk management and control objectives.

The activities executed by the “first and second line of defense” are supported by IT systems. These systems are designed to control and monitor the implementation of the management guidelines and the limits of each Fund/Mandate.

## *Valuation*

- Robeco has a valuation policy in place that describes per instrument group how the instrument is valued.
- To the extent possible, independent pricing sources are used for the valuation of derivatives.
- The Valuation Committee is responsible for establishing valuation guidelines of all assets and for taking decisions on valuations of assets without a current market price. Changes in valuation processes have to be approved by the Valuation Committee.

## **7.5 Currency**

Foreign currency exposures arise from investment in assets denominated in foreign currency. These exposures are considered to be part of the investment strategy of the applicable Fund/Mandate and Robeco manages the currency exposure.

The principles in this DRMS – part B for derivatives are applied to the management of foreign currency exposures and the use of foreign currency derivatives. Derivatives used for foreign currency management will be subject to limits and ranges that are consistent with the applicable Fund/Mandate permitted level of currency risk.

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## **8. Personnel management**

All Robeco personnel (including the personnel responsible for the management, processing and monitoring of derivative transactions) must have appropriate qualifications and relevant expertise. Investment decisions for the Funds/ (including the use of derivatives) are taken by portfolio managers

The human resource strategy of Robeco is built on the following pillars:

1. ‘Entrepreneurship and result-oriented management’
2. ‘Recruiting, retaining and developing talent’
3. ‘Strengthening cooperation and sharing knowledge’ (both management and staff)
4. ‘Intensifying exemplary behaviour and leadership’ (senior management)

By executing this strategy in combination with ‘on the job’ training and education, Robeco ensures that personnel maintain a high level of knowledge and skill.

## *Remuneration*

The remuneration policy of Robeco is such that it rewards employees according to their performance and incentivise excellence. The remuneration policy stimulates employees to exhibit desired behaviour and discourages undesirable conduct.

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## **9. Assessment of Controls**

Robeco's Control Framework is designed to ensure that business objectives are achieved through effective assessment and management of risk. The Executive Committee of Robeco is responsible for maintaining a strong control environment that encourages and supports the proper level of internal controls.

There are several risk management committees to ensure comprehensive and consistent risk oversight throughout Robeco. Risk oversight is a combination of internal audit and risk management functions. The Risk Management Committee Robeco ('RMC Robeco') is the highest body within Robeco that focuses on risks and is attended by key members of senior management. Within the committees, also discussion takes places to ensure the ongoing relevance and suitability of the internal controls. Control execution is monitored by management.

The control monitoring process includes checks to ensure that controls are being maintained and adhered to. Any breaches of limits or other restrictions are notified to the portfolio managers and escalated to the appropriate levels within Robeco.

Furthermore, internal and external auditors regularly review the internal control environment as do external regulatory authorities. The results of these audits are monitored and recommendations as an outcome of these audits are timely responded to.

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## **10. Audit**

This DRS is for this moment not subject to annual external audit.

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## **11. Reporting**

Robeco HK reports to the entities responsible for the Funds/Mandates it manages, in accordance with the terms agreed under the Governing Documents or IMA.

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## **12. Date of approval**

This DRMS – Part B is dated the 18 May 2017 and has been issues on the authority of the Board of Robeco Hong Kong Limited.