Challenger Investment Solutions Management Pty Limited

Solutions: Advice and Trading Process Practice Note

December 2022

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SUMMARY

Why is this Practice Note required?	The purpose of this Practice Note is to provide guidelines as to how the Challenger Solutions team provides non-discretionary advice and executes investor trade orders. The Practice Note also provides an overview of the advice process, order flow and settlement process, and outlines the checks that are in place to ensure all processes are conducted according to best practice.	
Who does this Practice Note apply to?	All legal entities, business and support function units and employees of Challenger, its agents, advisors, and contractors that act for or on behalf of Challenger Solutions.	
Incidents & breaches	It is important that incidents and breaches are reported promptly. Incidents and breaches are to be reported to Risk and Compliance and managed in accordance with the Incident Management Policy.	
Practice Note Responsibilities	**Governance**	The Directors of Challenger Investment Solutions Management Pty Limited bear the ultimate responsibility for corporate governance and operational risk management.
	Development & Maintenance	The Head of Solutions is responsible for the development and ongoing maintenance of this Practice Note.
	Implementation	The Head of Solutions, key stakeholders and all applicable staff are responsible for the implementation of this Practice Note.
Key Terms	**Challenger**	Challenger Limited and wholly owned subsidiaries and entities.
	Challenger Investment Solutions Management Pty Limited (CISM) or (Solutions)	The Solutions business that is a part of Challenger's Life and Solutions division.
	Client	Institutional funds or portfolios for which the Solutions team acts as fiduciary on either a discretionary or non-discretionary basis and provides investment management and/or advisory services.
	Derivatives	Depending on the specific mandate, however, this Practice Note covers Swaps, OTC and Exchange-Traded Options.
	Life and Solutions	The division within the Challenger Group that manufactures and distributes investment products for institutional and retail clients.
		Solutions is responsible for managing the execution of assets and derivative overlays on behalf of Clients across various assets classes.

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Investment Management Agreement (IMA)	An agreement between CISM and a Client in respect to investment management services that, among other things, specifies the Investment Guidelines for that Client.
ISDA Master Agreement (ISDA)	The ISDA Master Agreement is an internationally agreed document published by the International Swaps and Derivatives Association, Inc. which is used to provide certain legal and credit protection for parties who enter into over-the-counter or "OTC" derivatives transactions.
Markitwire	The trade affirmation platform for interest-rate swaps, equity options and swaptions.

1. Content of Practice Note

This Practice Note provides an overview of the advice process, order flow and settlement process, and outlines the checks that are in place to ensure all processes are conducted according to best practice.

This Practice Note supplements the other relevant Challenger and CISM policies and practice notes.

2. Scope

This Practice Note applies to all staff (including support functions) engaged (whether directly or indirectly) in market trading on behalf of the Solutions division of Challenger. The terms of the relevant Client agreement should be followed when trading on behalf of a Client directed mandate.

3. References

This Practice Note needs to be considered with reference to and taking account of the obligations laid out in Challenger Policies and the regulatory framework applicable to Challenger's operations, products, and services. Specific policies, which should be referred to include:

- CISM Solutions Allocation of Investment Opportunity Practice Note;
- Information Barriers Policy;
- Conflicts of Interest Policy;
- Group Delegated Authorities Policy;
- Derivative Risk Policy;
- Incident Management Policy;
- Inside Information Policy and Practice Note;
- Market Trading Rules Policy and Practice Note;
- Organisational Competency and Training Policy; and
- Related Party Transaction Policy.

4. Advice Process

1. The Solutions team meets with the non-discretionary Client, either in person or by telephone, and outlines the Client request. The team ensures that all relevant information is documented.
2. One to two Solutions team members model and price a number of different alternatives for the Client that will meet their goals and objectives.
3. The Solutions team collates all the data and pricing, and creates an email or document outlining the alternatives and an optimal scenario, expressly providing, if appropriate for the situation:
    i. a recap of the problem or investment outcome desired;
    ii. the alternatives which may achieve that goal;
    iii. a recommendation;

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      iv.   the pros and cons of the recommended alternative (including any risks); and
      v.   a scenario analysis if needed.

4.   The relevant Solutions team member will exercise care and diligence when preparing the scenario analysis, including a review to confirm that it achieves the desired outcomes and takes all the Client requirements into account.

5.   The analysis is sent to the Client with the approved disclaimer.

5. Compliance with the ATO's Taxpayer Alert TA 2020/5

The TA 2020/5 – "*Structured arrangements that provide imputation benefits on shares acquired where economic exposure is offset by the use of derivatives"* (Taxpayer Alert) outlines the Tax Commissioner's concerns around arrangements that may result in taxpayers inappropriately accessing the benefits of franking credits without taking any economic risk. It also provides examples of situations where this can occur by using derivatives.

The Solutions team should not enter into, or facilitate arrangements, outlined in the Taxpayer Alert. To manage this risk, the Solutions team will obtain a written undertaking or an attestation from the Client that the intended use of derivatives does not fall within the matters of concern outlined in the Taxpayer Alert. If the team have any doubt about a proposed transaction, they should seek advice from the General Manager, Tax. The following representation will be added to the Proper Instruction for Australian equity transactions:

[Client] represents that the transaction in this instruction is not for any of the purposes outlined in ATO Taxpayer Alert 2020/5.

6. Receiving Trade Instructions

The Investment Advisory Agreement states that the Client will provide Solutions written instructions to execute trades, specifying:

      i.   Nature and type of derivatives recommended to be bought or sold;
      ii.   Size of the trade;
      iii.   Timing of the trade, including whether timing is of the essence; and
      iv.   Other relevant economic details including but not limited to maturity, strike price and index.

Any changes to these instructions must be conveyed to Solutions in writing.

7. Trade Execution

Before trade execution. Solutions ensures two sets of eyes independently verify:

      i.   Security ID;
      ii.   Portfolio ID – specific to Client;
      iii.   Counterparty;
      iv.   Price;
      v.   Amount; and
      vi.   Any other relevant economic details including the initial margin impact where relevant.

Solutions will then liaise with banks where ISDAs are in place to source the best quote for a Client trade and provide written instructions to execute the trade.

8. Discretionary mandates & funds

For discretionary mandates and funds the discretion to enter, amend or terminate trades sits with the Portfolio Managers mentioned in the fund termsheet or mandate IMA.

Where a PM decides to enter into a transaction, that PM will draft an order and conduct pre-trade compliance checks either by:

1)   Building the order in Dimension and doing pre-trade compliance there; or

2)   Posting to the CIS "Trade Approval" Channel in Teams for 'four eyes' check by another team member.

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Once an order has passed pre-trade checks, any member of the CIS team may proceed to execute the trade.

9. Trade Booking Process

Once the trade fill is received from the counterparty for any discretionary or non-discretionary trades, it is checked against market data, and the original instruction in the case of the non-discretionary trades.

Ensure the details of the specific derivative contract are in the front end: for options, use Dimension's "Option Data" view; for a Total Return Swap (TRS) use the "Total Return Swaps" view. If the exact derivative contract is not found, request the Static Pricing team (StaticPricing@challenger.com.au) to "create" the derivative in Dimension, providing a screenshot from Bloomberg for reference. The Static Pricing team uses market sources to populate Dimension with price details of the specific derivative.

Specific templates are used for requesting new OTC derivatives and TRS security IDs from Static Pricing (available here: L:\Funds Management\Challenger Investment Solutions\Trading\Static). For TRS, the team will have to create the underlying index as well as the swap, but the single template will suffice. Turnaround is under 10 minutes for vanilla OTC instruments, such as futures and simple interest rate swaps. OTC options and TRS instruments can take longer and may require further clarification from front office. Static Pricing will confirm a unique "Security ID" to lookup the contract once this has been created.

Once the Security ID is confirmed, enter the relevant details to book the derivative trade. In Dimension, this is done through the "Trading View". For options use the Options > Trading view and for TRS use the "Open Total Return Swaps" view.

- For Options, specify Security ID, Strike Price, Option Type (Put Call)
- For Total Return Swaps, specify the Security ID, Counterparty, Custodian, Notional, Number of Units and Price
- For Equity Swaps, specify the Security ID, Legs: Fixed for Fixed/Floating

Change the main status request to "POSITION" to finalize booking the trade and click on the save icon. For Clients who have not executed before, front office must liaise with middle office to ensure the Static Pricing team sets up the portfolio ID in Dimension and that collateral linkages are created in order to properly collateralise the portfolio.

Figure 1: S&P/ASX200 Put trade booked into Dimension

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Figure 2: Total Return Swap booked into Dimension

9.1 Same day trades and cut-off times

Same day trades are defined as those booked into Dimension by 0900 AEST, hereafter 9 AM, on a business day (T).

Broker Cut-off: Trades must be entered by 9 AM for same-day trades. Trades entered after 9 AM will be traded on the next business day, T+1.

Custody cash instruction (for same day trades) cut-off times vary by custodian and currency.

10. Settlement

10.1 Trade Matching

Once a trade confirmation is received from the executing broker by paper or Markitwire, it is picked up by Investment Operations. Two people on the Derivatives and OTC team independently verify the broker confirmation has appropriate:

    i.   Standard settlement instruction;
    ii.   Trade/Settlement;
    iii.   Notional Amount;
    iv.   Reset Dates (quarterly/semi-annual); and
    v.   Currency.

This process of manual matching trades occurs by 9 AM for same-day trades or on a best-efforts basis for trades received after 9 AM, depending on when the broker sends the paper/Markitwire confirmation. There is a hard deadline of 9 AM on T+1 for confirming trades received after 9 AM on T. Upon completion of manual matching, the OTC and Derivatives team will change the trade status from "POSITION" to "FINCALC" in order to authorize the trade.

On a best-efforts basis, brokers provide same-day manual confirmation for derivatives trade orders sent before 9 AM on T. Otherwise, manual confirmation will be received by 9 AM on T+1.

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10.2 Trade Instruction (to custodian)

Following trade matching, the OTC and Derivatives team will authorize sending the trade to the custodian by T+1. Any corresponding cash flows will result in SWIFT instructions (occasionally faxes or directly to custodian's proprietary systems) generated from Dimension sent directly to custodians. Copies on the trade confirmation are also sent to custody for accounting purposes. The OTC team stores a copy of the Markitwire extract or manual confirm for all executed trades, searchable by Security ID.

Custody will reflect derivative transactions and generate SWIFT instructions for cash movements on S+1.

Figure 3: MarkitWire confirmation for an AUD 2 Year interest rate swap

MarkitWire IRS Deal Ticket

MarkitWire Trade Id:	70572773 Ver 1	Contract State:	New (Released)
Trade Version Timestamp:	19-Oct-2016 10:07:51 AM (GMT+11 hrs)		
Original Trade Date:	19-Oct-2016		
Internal Trade Id:	_SW28015062_2108670000		

Summary:

(Bradley Tinklin) pays FIXED

1.775000% on AUD 50,000,000
CITIBANK N.A. (SYDNEY) pays FLOATING 3-Month AUD-BBR-BBSW on AUD 50,000,000
Effective 20-Oct-2016 through 20-Oct-2018

FIXED AMOUNTS:

Fixed Rate Payer:	(Bradley Tinklin)		
Notional Amount:	AUD 50,000,000		
Payment Frequency:	Quarterly		
Effective Date:	20-Oct-2016	Eff Date Adjustment:	None
Termination Date:	20-Oct-2018	Term Date Adjustment:	Modified Following
		Term Date Bus Days:	Sydney
Rolls on:	20 th of month		
Fixed Rate:	1.775000%		
Fixed Rate Day Count Fraction:	ACT/365.FIXED		
Calc Period End Dates Adjustment:	Modified Following		
Calc Period Business Days:	Sydney		
Payment Dates Adjustment:	Modified Following		
Payment Business Days:	Sydney		
Payment Relative to:	Calculation Period End Date		

FLOATING AMOUNTS:

Floating Rate Payer:	CITIBANK N.A. (SYDNEY)		
Notional Amount:	AUD 50,000,000		
Payment Frequency:	Quarterly		
Effective Date:	20-Oct-2016	Eff Date Adjustment:	None
Termination Date:	20-Oct-2018	Term Date Adjustment:	Modified Following
		Term Date Bus Days:	Sydney
Rolls on:	20 th of month		

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Reset Frequency:	Quarterly
Floating Rate Option:	AUD-BBR-BBSW
Designated Maturity:	3-Month
Spread:	None
Initial Floating Rate:	None
Floating Rate Day Count Fraction:	ACT/365.FIXED
Calc Period End Dates Adjustment:	Modified Following
Calc Period Business Days:	Sydney
Payment Dates Adjustment:	Modified Following
Payment Business Days:	Sydney
Payment Relative to:	Calculation Period **End** Date
Reset Relative to:	Calculation Period **Start** Date
Fixing Dates:	0 Sydney Business Days prior to each Reset Date

11. Trade Reconciliation

Once a trade has been set to "FINCALC", an overnight process picks this up into Challenger's internal reconciliation system: Transaction Life Management Cycle (TLM). TLM is populated with every portfolio's daily (trade) activity files and end-of-day balances from Dimension and by the custodian uploading SWIFT instructions for cash movements for matching portfolio trades by S+1 (latest).

The Challenger Portfolio Control team reconciles cash and trade positions on a daily basis and investigates any discrepancies.

Dimension uploads daily derivative positions via secure-FTP into "triResolve" to provide marked-to-market based reconciliation between internal systems and custody. These are reconciled monthly against broker supplied positions.

12. Mitigating Trade Errors

Trade errors are defined as any breaks from the normal trading process. These encompass:

- Trade mismatches
- Fat finger trades
- Instruction Errors
- Reconciliation Errors

To mitigate the occurrence and severity of trade failures, Solutions utilizes a "two pairs of eyes" approach at each step of the trade flow process:

12.1 Trade Flow Process Verification

1. Executing Trades - two Solutions traders will independently verify security ID, portfolio, counterparty, price and amount to be traded before trades are booked.

2. Trade Confirmation – Executed orders from the banks will be confirmed by two Solutions traders and subsequently confirmed to the Client via email.

3. Trade Matching – Markitwire provides independent verification of swap trades. Investment Operations OTC Derivatives team will verify trade confirms from brokers.

4. Trade Instruction (to custodian) – only takes place after trades have been matched on T+1. Custody keeps track of Client capital flows and can record breaks, which will be reconciled by Challenger's internal TLM process.

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5. Reconciliation – External triResolve system used monthly to reconcile Dimension portfolio positions and valuations against broker positions and valuations

13. Collateral Management

On a daily basis, the Solutions team values all derivative positions and evaluate these positions against existing collateral positions. The team uses Dimension's "Collateral Manager" to maintain minimum transfer amounts, haircuts, etc. and determine how much collateral the business owes or is owed every day. Solutions calls money on a daily basis where the business is owed money and settles cash via the custodian.

14. Dispute Resolution

The Investment Operations team has a process to escalate material disputes to the Solutions team. If the Solutions team is unable to resolve the dispute with the counterparty, the dispute will be reported to the Client (consistent with APRA Prudential Standard CPS 226).

15. Portfolio Compression

Client portfolios will be periodically assessed to determine opportunities for compression, as per APRA Prudential Standard CPS 226. If opportunities are identified, they will be discussed with the Client. Portfolio compression will be carried out upon receipt of the Client's instructions.

16. Recording triggers for action / discussion

Where a Client portfolio contains a trigger for action or discussion, the trigger and action will be recorded using Bloomberg Alerts (or similar functionality).

17. Risk Review

Where necessary, the Risk and Compliance team will undertake periodic reviews of Solutions' compliance with the provisions of this Practice Note.

18. Related Party Transactions Policy

Challenger has a Related Party Transaction Policy which requires that any transaction between related parties is conducted on arm's length terms. Further, the Related Party Transaction Policy requires a demonstration of the arm's length nature of the terms.

These approaches will apply in any circumstance where a transaction is undertaken between related parties. This may include transactions such as the sale of an asset from one party to another, or the provision of services for which a fee is charged.

19. Training and Awareness

The Head of Solutions, key stakeholders and all applicable staff are responsible for the implementation and awareness of this Practice Note.

20. Whistleblower Provisions

Challenger has a Whistleblower Policy and encourages disclosures from employees, former employees, and suppliers regarding any unethical, illegal, corrupt, or other inappropriate conduct including in relation to this Practice Note. The Whistleblower Policy is available on Connect and www.challenger.com.au.

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21. Risk Appetite and Complying with this Practice Note

Challenger's purpose is to provide customers with financial security for a better retirement. Challenger promotes a positive culture of risk awareness and transparency, including open communication and challenge of current and emerging risks, speaking up regarding matters of concern and the proactive management of issues and incidents. Challenger has no appetite for conducting business activities unfairly or in contravention of the law, or which knowingly damage or are inconsistent with its brand and reputation. Challenger has no appetite for employees intentionally not following policies and procedures.

Employees are to comply with Challenger policies and are responsible for familiarising themselves with the policies relevant to their role. Policies are available on the intranet.

Incidents of non-compliance with this Practice Note are to be reported in line with the Challenger Incident Management Policy.

Employees at Challenger are held accountable for their actions. Consequences for non-compliance with this Practice Note may include but are not limited to:

- a requirement to undertake additional training;
- increased supervisions;
- a verbal warning;
- a written warning (including a first and final written warning);
- an impact to performance rating or promotion;
- a financial consequence; and
- dismissal.

For further details, please refer to the Challenger Limited Conduct Risk and Consequence Management Framework.

22. Point of Contact

The Head of Solutions is the point of contact for matters arising from this Practice Note.

23. Review Cycle

This Practice Note will be reviewed every two years or as deemed necessary by the Head of Solutions. Any material changes will be required to be communicated to Clients as promptly as possible.

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