

## **Derivatives Risk Statement for Orbis Investment Management Limited and Orbis Investment Management (B.V.I.) Limited (collectively “Orbis”) prepared in accordance with the requirements of the Australian Prudential Regulatory Authority**

### **1. Responsible party names**

Orbis Investment Management Limited and Orbis Investment Management (B.V.I.) Limited. This derivatives risk statement (“DRS”) applies to collective investment schemes (“Funds”) for which a responsible party is appointed the investment manager.

### **2. Objective of DRS**

This statement summarises the policies in place covering the use of derivatives by Orbis in its investment strategies, controls on the uses of derivatives, and the processes for assessing compliance with those controls.

### **3. Definition of derivatives**

A derivative is defined as: “a financial contract whose value depends on, or is derived from, assets, liabilities or indices”. Derivative transactions include a wide assortment of instruments, such as forwards, futures, options, share ratios, warrants, swaps and other composites.

Orbis uses primarily stockmarket index futures contracts and currency forward contracts. While the Funds in which Orbis deploys its investment strategies are permitted to use other derivatives, it is expected that their use will be only incidental and will not have a substantial impact on the overall investments of Orbis’ Funds, so they are not explicitly covered by this statement.

### **4. Relationship to Investment Strategies**

The investment strategy for each Fund is detailed in the prospectus, information memorandum or other offer document relevant to each Fund.

Derivatives are employed as a tool in the implementation of the investment strategy of each Fund as a whole. Orbis does not use derivatives to achieve investment positions or exposures that are inconsistent with the investment strategy and restrictions for each Fund, and there are controls in place to ensure this.

In many of the Funds managed by Orbis, currency hedging is deployed to adjust the currency exposure of the Fund’s investments either for structural or active currency management purposes. Currency hedging has been and is expected to be the main use of derivatives in the long only equity Funds managed by Orbis.

Orbis also manages Absolute Return Funds, which employ investment strategies that seek absolute (i.e. positive returns) regardless of stockmarket trends. Orbis manages a Fund’s stockmarket risk principally by the Fund establishing a basket of stockmarket-based derivatives usually comprised of short positions in stockmarket index futures. For those Absolute Return Funds that employ financial leverage, Orbis may utilise bond futures to take positions that reflect Orbis’ view on the future level of interest rates.

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

Orbis uses currency forward contracts to sell one currency forward for another to manage the currency exposure of the Fund.

Orbis uses stockmarket index derivatives to vary a Fund's exposure to stockmarkets. In the Absolute Return Funds, the use of derivatives to hedge stock market risk is a core component of the investment approach of the Funds. In the case of long-only equity Funds that are permitted to utilise futures, the use is incidental, e.g. to maintain stockmarket exposure during large cash subscriptions or redemptions.

Orbis also uses bond futures contracts in those Absolute Return Funds that employ leverage to take positions which reflect Orbis' view on the future level of interest rates.

## **6. Restrictions on the use of derivatives**

Details on the restrictions on the use of derivatives that apply to a Fund can be found in the investment restrictions section of the Fund's prospectus, information memorandum or other offering document, copies of which are available from Orbis upon request.

## **7. Risk analysis**

There are various types of risks associated with Orbis' use of derivatives.

### **7(a) Market risk**

The currency risk that a Fund takes by deviating from its currency benchmark is monitored using a number of tools that calculate VAR estimates for this risk, and are quickly available to the Portfolio Manager and the Traders.

In the Orbis Absolute Return Funds, the level of stockmarket hedging and active trading positions are monitored and analyzed using an application which displays the target market neutral hedge, the target trading positions and difference between the total desired trading positions (i.e. market neutral hedge plus trading positions) and the actual trading positions. Traders use the application to see where trades must be made to rebalance the portfolio.

Basis risk can be viewed as the extent to which valuations for derivative securities do not precisely reflect valuations for the underlying instruments on which they are based. Orbis manages this basis risk by investing whenever reasonably practicable in liquid derivatives instruments based on underlying instruments that are also liquid.

### **7(b) Liquidity Risk**

The risk of difficulty in unwinding a currency forward position is considered to be minimal due to the size of market, one of the largest in the world. This enables offsetting positions to be easily and quickly effected when required. Liquidity risk associated with capacity to meet obligations is minimised by managing the Funds to ensure that subject to pre-determined tolerances due to passive market movements, the Funds are not over-invested. This is achieved by maintaining the ability to cover unrealised accrued losses on open currency forward positions and margin calls on futures contracts.

The risk of unwinding a futures position is controlled by ensuring futures positions are

predominantly in the form of listed contracts that are the most liquid of the offered contracts on the particular index or instrument.

### **7(c) Counterparty (Credit) risk**

Orbis seeks to minimise a Fund's credit and contractual risk to counterparties on forward and futures contracts by (i) using exchange traded contracts (i.e. not using over the counter contracts) whenever reasonably practicable, (ii) the careful selection of counterparties, (iii) managing the amount of margin deposits, (iv) limiting the level of unrealised gains on forward contracts; and (v) using industry standard netting agreements to reduce both the aggregate settlement amount of outstanding forward derivative contracts and the unrealised gains thereon. As these contracts expose the Fund to credit risk arising from the potential inability of a counterparty to return margin deposits and otherwise perform under the terms of a contract, the Funds deal only with counterparties which have investment grade ratings from a recognised rating agency and which have provided a parent guarantee, where applicable.

Various personnel in Orbis (traders, fund accounting and compliance) receive at least daily reports about open currency and futures positions, both on a net basis and a gross basis.

Legal documentation is in the form of ISDA agreements; futures trading agreements and contracts are reviewed, settled and stored by Orbis legal counsel.

### **7(d) Operations risk**

The derivatives employed by Orbis are relatively simple instruments that are traded in well-developed markets with complete price transparency so the risk of incorrect valuation is remote. Valuations of futures and currency forwards are performed by the Fund's independent Administrator in accordance with current industry market practice (e.g. futures and forwards are marked to market) and those valuations are reviewed by Orbis' fund accounting personnel as a second check.

Within Orbis, separate teams handle each of the follow functions (1) futures and currency trading, (2) portfolio management, and (3) fund accounting and settlement.

## **8. Currency**

As Orbis' currency derivative use is largely confined to forward currency contracts, the risk management principles for foreign currency management are addressed throughout this Derivative Risk Statement.

## **9. Personnel management**

The trade process is broken down by function and procedures are in place to help ensure that separate departments within Orbis and independent entities outside Orbis carry out the functions within their area of responsibility.

The trade process starts with the Portfolio Manager who sets the target equity, hedging and f/x exposure for a Fund. The target exposure set by the Portfolio Manager is communicated to Orbis' traders and also logged for attribution purposes. The traders are responsible for carrying out the transactions required to achieve the target exposure and have limited ability to take additional incremental positions.

Upon receiving instructions from the Portfolio Manager, the trader loads the prospective trade into a proprietary trade order management system designed to (in addition to trading functionality) check the trade's compliance with the particular Fund's investment restrictions. After this check is run, the trader determines how best to manage the order. All orders are communicated via recorded lines and in most instances fills are received back from the broker electronically. Upon signing off on a trade (each trader has a unique password), an electronic copy of that trade is available for the middle office to process the trade(s) for settlement. In addition to an electronic signature, each trade blotter is signed off physically and also delivered to the middle office. A second trader signature is required within 24 hours on all hard copy blotters.

Orbis' middle office checks that the trade blotter is dated and time stamped and has the necessary authorised trader signatures. The middle office verifies the trade details on the blotter and then proceeds to electronically fetch the trades into the back office accounting system. The middle office then checks all amounts are correct and then posts the trades into a proprietary portfolio management system. Trade tickets with back up are forwarded to an authorised signatory within the accounting group for review and signature. If electronic confirmations are received, Orbis and the counterparty send the trade details to a third party service provider's automated matching system, which matches the two trade detail reports and issues a report confirming the match or identifying any discrepancies. If the trade confirmation is non-electronic, the trade will show in Orbis' Tradeflow matching engine as "unmatched" and stay as unmatched until someone in Orbis' middle office manually matches the trade by reviewing the paper confirmation of the trade to indicate the items agree to our trade advice and then going into Tradeflow and indicating the trade has been "manually matched". A trade will remain on Tradeflow until it is matched and Tradeflow will send out alerts via email once 24 hours has passed if a trade remains unmatched. Once the authorised signatory is satisfied with the technical details of the trades in the Trade Blotter, then an authorised individual is ready to electronically send the trade to the Fund's Custodian. .

The Orbis Funds appoint an independent Administrator to administer the computation of the net asset value per share of the Funds, and to perform other general administrative functions, including accounting and compliance. Orbis will send over a trade log to the Fund Administrator on a weekly basis. The Administrator's valuation department will ensure that Orbis' records reconcile to what they have received from the Fund's Custodian.

Orbis' Fund Accounting and Administration Department in conjunction with Orbis' compliance team perform an independent check of the internal audit/compliance functions carried out by the Orbis Funds' Administrators. Monitoring is undertaken using a combination of systems-based compliance checks and individual oversight and supervision.

This DRS is posted on Orbis' intranet, where it is available to all staff. Orbis' compliance personnel will provide traders and other relevant staff periodic training and review of the obligations they face in order to ensure that the requirements in this DRS are met.

## **10. Assessment of controls**

Each of Orbis' Funds has an independent (i) Custodian to process and settle trades, reconcile cash movements for the Fund and act as the depositary for the Fund's cash and securities and (ii) Administrator to administer the computation of the Net Asset Value per Unit or Share of the Fund, and to perform other general administrative functions, including accounting and compliance.

Orbis' Fund Accounting and Administration Department calculates at least daily the net asset values of the Fund independently of the Administrator. As part of the margining process, Orbis

reconciles futures positions daily to the counterparties' statements. In addition, Orbis' Fund Accounting and Administration Department in conjunction with Orbis' compliance team perform an independent check of the internal audit/compliance functions carried out by the Administrator. Monitoring is undertaken using a combination of systems-based compliance checks and individual oversight and supervision.

Orbis' Compliance Officer reports any material problems to Orbis' and the Funds' boards of directors and ensures that any problems that do occur are subject to prompt corrective action.

#### **11. External audit**

An external auditor will be engaged on an annual basis to examine whether the major procedures laid down in this DRS have been followed and that any changes have been approved. The external audit will be completed in accordance with Australian Auditing Standards and referenced as appropriate in letters of comfort.

#### **12. Reporting to Trustees**

This DRS will be provided to the Trustee of the Orbis MIS – Orbis Global Equity Fund and the Trustee will be provided with an updated risk statement in the event there are any amendments. In particular, Orbis will ensure that it can regularly inform the Trustee of the aggregate portfolio exposure, including the impact of derivatives. Orbis will also report to the Trustee when in the professional judgment of Orbis there is a significant occurrence in relation to the use of derivatives in the Orbis MIS – Orbis Global Equity Fund.

#### **13. Date of approval**

The boards of directors of Orbis approved this DRS on October 12, 2006.