



futurefund

**Submission to the
Finance and Public Administration Legislation Committee
Inquiry into the
Government Investment Funds Amendment
(Ethical Investments) Bill 2011**

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SUMMARY

Existing framework

The existing legislation and governance structure of the Future Fund is widely considered to be of world class standing.

The existing framework is characterised by:

- a clear objective;
- clearly defined parameters and definitions;
- consistency in approach over time;
- governance arrangements that establish the Board's independence and accountability; and
- clear roles and responsibilities for Ministers and the Board.

Comments on the Bill

The provisions of the Bill present a number of practical challenges. These include:

- unclear or ambiguous standards;
- requirements that may change over time creating uncertainty; and
- clouded governance arrangements.

The implications of these issues may include:

- a more difficult environment in which to apply the investment program;
- reduced access to managers and strategies;
- a shorter investment horizon;
- reduced independence and ability to operate at best practice; and
- increased costs and resource requirements.

The Future Fund believes it would be appropriate to revisit the current risk and return target for the Future Fund if the Bill were to pass.

The Future Fund has identified best practice approaches to portfolio exclusions. We have not identified any approaches to exclusion similar to those proposed by the Bill.

INTRODUCTION

In response to a request to Mr Mark Burgess, Managing Director of the Future Fund Management Agency, the Fund is pleased to provide this submission on the Government Investment Funds Amendment (Ethical Investments) Bill 2011.

The Future Fund operates under the legislative framework established by Parliament and it is for Parliament to determine whether changes to the existing framework are appropriate. The Future Fund hopes that it can contribute to the Committee's considerations by summarising:

- the context and current statutory arrangements;
- relevant practical issues raised by the proposed Bill;
- the potential effects of the Bill on the investment program and return target; and
- the various approaches taken by institutional investors globally to similar issues.

CONTEXT AND CURRENT STATUTORY ARRANGEMENTS

The Future Fund is a financial asset fund established by the Future Fund Act 2006. Its purpose is to make provision for unfunded superannuation liabilities that will become payable during a period when an ageing population is likely to place significant pressure on Commonwealth finances.

The Future Fund Act 2006 established the Future Fund Board of Guardians and the Future Fund Management Agency. The Board of Guardians was established as a separate body corporate with responsibility for investing the assets of the Future Fund.

The Nation-building Funds Act 2008 established the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund as financial asset funds and gave the Board responsibility for investing the assets of these Nation-building Funds.

The statutory arrangements for the establishment and operation of the Future Fund and Nation-building Funds and the Future Fund Board of Guardians, supported by the Future Fund Management Agency, include a number of important characteristics:

A Clear Risk and Return Objective

The Investment Mandates for all four funds are focused on seeking to maximise returns within a defined level of risk. For the Future Fund the objective is to target a benchmark return of CPI +4.5% to 5.5%pa over the long term with acceptable but not excessive levels of risk. Accordingly, the Future Fund portfolio is diversified across a broad range of asset classes. For the Nation-building Funds the return target is the three month bank bill swap rate +0.3%pa over rolling 12 month periods while minimising the probability of capital losses over a 12 month horizon. Accordingly, the Nation-building Funds are invested in short and medium term debt instruments only.

A key characteristic of the arrangements is that the Board is to target a clear financial objective.

Independence from Government

The statutory arrangements establish a framework that provides for investment-decisions to be made at arm's length from Government while providing appropriate accountability and oversight arrangements. In particular:

- the legislation sets out clear responsibilities for the Board and the responsible Ministers, with the Board responsible for investing the assets of the Funds and the responsible Ministers responsible for appointing Board members who must be drawn from outside Government. Board members must meet the requirements of having substantial expertise and professional credibility in investing, managing financial assets or in corporate governance;
- the Board must be consulted on draft investment directions and any submissions the Board makes on a draft direction must be tabled in Parliament; and
- the expenses of each Fund are met from the assets of the Funds themselves rather than from appropriations through Parliament.

Broad Investment Parameters

Consistent with the overall objective of the Funds and the clear risk and return objectives, the legislation and investment mandate allow the Board to construct a portfolio comprising a wide range of investment opportunities and to operate relatively freely in the market alongside other large institutional investors.

International Best Practice for Institutional Investment

The legislation requires the Board to seek to maximise returns on the Future Fund over the long term, consistent with international best practice for institutional investment. This is reinforced by the arrangements in the Investment Mandate, which require the Board to have regard to international best practice for institutional investment, including in relation to its voting policy.

BENEFITS OF THE CURRENT ARRANGEMENTS

The Future Fund framework is characterised by having:

- a clear objective;
- clearly defined parameters and definitions;
- consistency in approach over time;
- governance arrangements that establish the Board's independence and accountability; and
- clear roles and responsibilities for Ministers and the Board.

These characteristics have played a significant role in the Future Fund's ability to develop and implement effective investment strategies and to establish a successful organisation that has grown the assets of the Fund during an exceptionally challenging investment environment.

FUTURE FUND'S APPROACH TO ESG AND PORTFOLIO EXCLUSIONS

The Future Fund has developed a clear investment program, designed to pursue its statutory objective, that incorporates an Ownership Rights and ESG Risk Management Policy. The policy provides for the exercise of ownership rights to support good governance and to protect and enhance investment value and for the integration of relevant ESG issues into investment decision-making. The policy also provides a framework for considering exclusions from the portfolio.

Under its policy the Fund has excluded ten companies on the basis of their involvement in the manufacture of cluster munitions and/or landmines.

The organisation has progressively developed the Ownership Rights and ESG Risk Management Policy, publishing the most recent version in February 2012 and establishing a Governance Committee of the Board in May 2012 which will review the policy and its implementation going forward.

A copy of the Ownership Rights and ESG Risk Management Policy is provided in Appendix 1.

PARAMETERS OF THE BILL

The Bill sets out a number of arrangements applicable to the Future Fund and Nation-building Funds. Specifically the Bill provides for Ethical Investment Guidelines that:

- must specify financial assets, or financial assets of a kind, that are prohibited financial assets;
- may make provision for or in relation to socially responsible ethical investment practices (including but not limited to) environmental concerns, human rights concerns, labour practices and the manufacture of weapons of war;
- prohibit an interest in a body corporate that manufactures tobacco products;
- prohibit an interest in a body corporate that produces components for cluster munitions; and
- prohibit an interest in a body corporate that produces, maintains or simulates nuclear weapons.

PRACTICAL ISSUES RAISED BY THE BILL

The Future Fund notes the following practical issues relevant to implementing the provisions should the Bill be passed.

Ambiguity and Breadth of Provisions

Tobacco

Industry category codes can be used to identify companies in certain industries or sectors, such as tobacco, and this can be used in a process to exclude companies. However, this process will not cover companies that sit outside the category code. As an example, there may be instances in which a body corporate could be involved in producing tobacco products but be classified under another category on the basis of its broader corporate activities.

Cluster munition component producers

The Future Fund notes that the Bill does not require the exclusion of the producers of cluster munition systems, but that the Fund has already implemented such exclusions under the arrangements of its existing Ownership Rights and ESG Risk Management Policy.

By incorporating a prohibition on investment in producers of components for cluster munitions, the Bill creates a broad category for exclusion that reduces clarity and makes implementation more complex. There is no readily available industry standard to assist in identifying component producers for exclusion. In particular a definition of what constitutes a component would be needed and a relevant consideration may also be to what extent a component is central to the production of a munition. From a control and application perspective a prohibition on component producers increases complexity in managing the portfolio.

Production, maintenance and simulation of nuclear weapons

Similarly to the discussion of cluster munitions components above, the Future Fund notes that there is no readily available industry category code to assist in identifying companies for exclusion and that there are a wide range of approaches taken by other investors.

It is also relevant to note that there is frequently significant ambiguity involved in assessing whether a company is involved in a particular activity¹. While a number of service providers and investors provide research and reports in relation to this, there is general acceptance that a degree of subjectivity and ambiguity is involved. Again, from a control and application perspective a prohibition relating to nuclear weapons as provided by the Bill would increase complexity in managing the portfolio.

It could be expected that many of the same considerations would be relevant should the responsible Ministers determine other prohibited financial assets to be included in the Ethical Investment Guidelines.

¹ For example, among four leading institutional investors that exclude on the basis of some association with nuclear weapons, only one company is excluded by all four investors. Seven companies are excluded by three of the investors. Six companies are excluded by two of the investors and 16 companies are excluded by just one of the four investors.

Socially responsible ethical investment practices

The provisions relating to 'socially responsible ethical investment practices' are unclear. The Future Fund is not able to assess how it would practically implement these provisions in the absence of specifically tailored and defined arrangements, such as might typically form the provisions of a Bill.

The Future Fund notes that, in light of the above points, it would be likely that the organisation would need to seek adequate clarity from the responsible Ministers rather than attempt to interpret the expectations of Ministers. This would tend to involve Ministers in specific elements of the investment program at a detailed level and in a manner which is currently not the case.

This raises clear implications for the independence of the Fund.

Changing Parameters

The Future Fund notes that the Ethical Investment Guidelines would be subject to change at the discretion of the responsible Ministers. This raises the prospect that the guidelines would change requiring the Fund to revise and adjust its investments accordingly. This raises practical issues in terms of monitoring and resourcing and in ensuring that each set of guidelines are sufficiently clear.

Moreover, the impact of changes in the requirements of any Ethical investment Guidelines is highly relevant when it comes to considering the effects of the Bill on the implementation investment program. This is discussed later in this submission but could be expected to reduce diversification, hinder the ability to implement long term strategies, impair the Fund's attractiveness to partners and ability to access some strategies while increasing costs and administrative obligations.

Balancing Competing Requirements and Clarity of Governance

The Future Fund notes that it would need to monitor and assess potential conflicts between its financial risk and return objective and the prohibitions and exclusions, and more particularly any 'socially responsible ethical investment practices', provided under the Ethical Investment Guidelines.

The Future Fund has had a single clear objective and hierarchy of priorities, with the focus on maximising returns subordinate to the parameters of the legislation and the investment mandate. The Bill is unclear as to how the Fund would determine where to place the Ethical Investment Guidelines in its priorities and how it would go about balancing potentially conflicting requirements between those Guidelines and its existing mandate. The lack of clarity on governance hierarchy is an important change from the current clearly defined structure. This would be exacerbated in a situation where the requirements are unclear, broad or change over time and would be likely to impact on the overall efficiency and performance of the portfolio.

Application Across Strategies

The Future Fund also notes that different approaches would need to be taken to applying the provisions across the breadth of strategies within the portfolio. As noted above, it is possible to use industry category codes to help identify companies for exclusion, but this approach is imperfect and the practical measures the Future Fund could apply would be driven by the actual Ethical Investment Guidelines and the complexity and extent of the provisions.

EFFECTS OF THE BILL ON THE INVESTMENT PROGRAM

The Future Fund considers that the following effects on the investment program could be anticipated as a result of the provisions of the Bill.

Less Diversification/Reduced Opportunity Set

To the extent that the Future Fund is prohibited from investing in companies or sectors, so its ability to construct a diversified portfolio is reduced. As prohibitions increase or become more complex over time so this is exacerbated, running in conflict with the need to build a diversified portfolio in accordance with the current Investment Mandate.

It should also be noted that many organisations, including those with activities in the defence, technology and aerospace sectors, typically have diversified operations. The proposed prohibitions may result in the exclusion of companies that operate across multiple sectors reducing the ability to invest in significant areas of economic activity.

The Future Fund also notes that open-ended and unclear definitions can generally be expected to result in a broader range of exclusions with flow on effects to the diversification of the portfolio.

Shorter Investment Horizon

The prospect of ongoing changes to the prohibitions or to the provisions for 'socially responsible ethical investment practices' (and the scope for changes in the interpretation of ambiguous terms) may reduce the ability for the organisation to maintain its long-term investment perspective. This may be an important consideration in working with peer investors on long term projects and may reduce the reliability of the Fund as an investment partner.

Reduced Access to Managers and Strategies

The Future Fund anticipates that the broader and more complex prohibitions under the Bill are, the harder it will be to effectively and efficiently apply the requirements to the portfolio. In particular, it is likely that the ability to gain access to certain high quality investment managers and to pursue particular investment strategies, such as illiquid strategies and those where the Future Fund is a minority investor through a single vehicle alongside multiple other investors, will be reduced.

Independence and Reputation

The independence and accountability arrangements under which the Future Fund has operated since inception have been central to enabling the organisation to focus on pursuing its statutory objectives.

The fact that the Future Fund makes investment decisions independently of Government is well recognised in investment markets. Should this independence be reduced as a result of an uncertain and changing range of excluded investments and 'socially responsible ethical investment practice' requirements mandated by Ministers, the Future Fund is concerned that its ability to operate commercially and its ability to operate as a reliable participant in global markets may also be reduced.

Impaired Best Practice

The Future Fund takes seriously its obligations under the legislation and investment mandates to consider international best practice in all aspects of its investment program. Noting the potential effects of the Bill on the investment program as outlined above, the Future Fund is concerned that the ambiguity, complexity and practical challenges of applying the provisions would hinder its ability to meet its best practice objectives.

Costs and Efficiency

The Bill would require the Future Fund to apply additional monitoring and reporting arrangements to the portfolio increasing direct costs and the administrative burden on the organisation. Where the parameters for prohibitions and for 'socially responsible ethical investment practices' are unclear or hard to define these costs will be increased. The Future Fund also notes that in addition to these monitoring and administrative costs, management would need to allocate increased time and focus to establishing and overseeing the arrangements and to negotiating implementation through our partners and service providers.

IMPACT ON THE RETURN TARGET

Considering these practical implications and their effects on the investment program, we believe it would be appropriate to revisit the risk and return target for the Future Fund if the Bill were to pass, in particular given the unclear and potentially broad scope of the Bill.

The Future Fund also notes that further reviews of the risk and return target would need to be considered over time should new prohibitions and provisions for 'socially responsible ethical investment' be applied by successive Ministers.

APPROACHES TAKEN BY INSTITUTIONAL INVESTORS GLOBALLY TO SIMILAR ISSUES

The nature and extent of exclusions applied to portfolios for non-financial reasons varies and there is diversity in the arrangements and models used.

Global Best Practice Frameworks

Based on its experience and review of various approaches the Future Fund's view is that best practice frameworks covering portfolio exclusions reflect:

- a clear articulation of the institution's objective;
- a focus on clear investment objectives;
- specific, rather than open ended, parameters;
- consistency in application over time; and
- governance arrangements that align with broader independence and accountability structures. This includes defined roles and responsibilities for the asset owner and asset manager.

A Review of Peer Funds

The Future Fund also notes that it should not be assumed that the use of exclusions is a standard practice for institutional investors globally. We note that of 22 sovereign pension, reserve or wealth funds reviewed² a range of funds, including funds in Canada (Fonds de Solidarité), France (Fonds Stratégique d'Investissement), Korea (National Pension Fund of Korea), Singapore (Government Investment Corporation and Temasek) and the United States (Alaska Permanent Fund), are not known to apply any exclusions.

Of the group of 22 reviewed, three funds have exclusions related to tobacco, nine funds have exclusions relating to cluster munitions and landmines and three have exclusions associated with nuclear weapons.

Specific Peer Examples

More broadly, as shown overleaf, among investors that do practice exclusion, the extent and nature of those exclusions varies, with exclusions related to cluster munitions and land mines more prevalent than those for other reasons.

Common across the funds that apply exclusions is the use of a best practice framework as outlined above.

In most cases consideration of exclusions is done at the Board level, with Norway an exception. The Fund is not aware of any arrangements that allocate decisions on prohibition solely to a Minister.

² A cross section of funds in Canada, China, Denmark, France, Hong Kong, Ireland, New Zealand, Norway, Singapore, South Korea, Sweden, United Kingdom and the United States.

- Canada: the Canada Pension Plan excludes companies that are not in compliance with the MBT and is considering exclusions based on the CCM. It does not apparently make exclusions based on tobacco products or any other economic activities;
- Denmark: ATP, the mandatory state pension scheme, excludes certain companies on the basis of the CCM and MBT. It does not exclude companies on the basis of tobacco products or nuclear weapons;
- France: the pension reserve fund Fonds de Réserve pour les Retraites excludes certain companies on the basis of the CCM and MBT. It does not exclude companies on the basis of tobacco products or nuclear weapons;
- Netherlands: ABP, the pension fund for public sector employees, has excluded certain companies on the basis of the CCM and the MBT, but has no blanket exclusion on nuclear weapons, nor does it exclude tobacco products. PFZW, the second largest pension fund in the Netherlands, is the default occupational pension fund for the public healthcare sector but does not exclude tobacco products. It does exclude in relation to cluster munitions, landmines and nuclear weapons;
- New Zealand: the New Zealand Superannuation Fund, excludes companies based on the Convention on Cluster Munitions (CCM) and Mine Ban Treaty (MBT), as well as on the basis of tobacco products and nuclear weapons;
- Norway: the Government Pension Fund Global excludes companies based on the Convention on Cluster Munitions (CCM) and Mine Ban Treaty (MBT), as well as on the basis of tobacco products and nuclear weapons;
- Sweden: the state AP Funds 1 to 4 exclude certain companies on the basis of the CCM and the MBT, based on the recommendation of the Ethical Council that advises the four funds. AP7 independently excludes on the basis of the CCM and MBT, and producers of nuclear weapons. None of the AP funds exclude tobacco products; and
- United States: The California Public Employees' Retirement System excludes tobacco products, but does not make any weapons-related exclusions.

CONCLUSION

Parliament determined the current legislative framework under which the Future Fund operates and it is for Parliament to determine any alterations to those arrangements.

In this submission the Future Fund has sought to emphasise the valuable qualities of the existing framework: clear risk and return objectives, independent investment decision-making, the absence of limitations on the Board's ability to act commercially to pursue the mandated objective and the value of considering best practice arrangements.

The Future Fund has also noted the practical challenges presented by the Bill, including the degree of ambiguity, changing parameters, the need to balance competing requirements and the challenges of applying provisions across diverse strategies.

These practical challenges can be expected to impact the investment program by reducing diversification and the available opportunity set, shortening the investment horizon, reducing access to managers, reducing the ability to pursue best practice approaches and increasing costs and resource requirements.

The Fund notes the implications of removing the current structure of independence in decision making. The potential implications of removing this independence should, in the Fund's opinion, be given serious consideration by the Committee

Accordingly the Future Fund has noted the potential impacts of the Bill's provisions on the current portfolio and its view that it may be necessary to revisit the current risk and return objective set in the Investment Mandate should the Bill proceed.

APPENDIX 1 – EXTRACT FROM THE FUTURE FUND'S STATEMENT OF INVESTMENT POLICIES

Ownership Rights and ESG Risk Management

1.1. Introduction

The relevant legislation and investment mandate provides a clear framework for the Board to seek to maximise returns on the Fund subject to the constraints of acceptable but not excessive risk. Pursuit of the Future Fund's benchmark return with acceptable risk requires the Board to maintain a broadly diversified portfolio. Accordingly, the Board expects to have part ownership, on behalf of the Commonwealth, of a very large number of entities that derive income from a wide variety of economic activities.

The Board believes that effective management of material financial and reputational risks and opportunities related to environmental, social and governance (ESG) issues will, over the long term, support its requirement to maximise returns earned on the Funds. The Board builds this perspective into its own investment decision-making, including the management of ownership rights, and into its process for selecting the external investment managers responsible for individual investment decisions.

In particular, the Board believes that there is a positive relationship between good governance and investment value and acknowledges the value of exercising its ownership rights, including voting rights where relevant, across the broad range of its investments.

Accordingly, the Board will act as a prudent investor seeking to encourage through its ownership activities the adoption of good governance practices in the entities in which it invests.

1.2. Acting through governance

As an asset owner focused on maximising long-term returns, in the entities in which it invests the Board will exercise its ownership rights to encourage governance arrangements that support:

- i) Proper treatment of the share or capital holder;
- ii) The appointment and retention of fiduciaries (or their equivalents) of the highest quality; and
- iii) High standards of behaviour in regard to, governance, transparency and accountability, management of environmental and social risks, business ethics, compliance with relevant legislation and regulation, effective management of relationships with employees and regulators, and a holistic approach to the risks and opportunities that will be encountered by the entity.

The Board has a statutory obligation to invest through external investment managers. These managers are often in the best position to analyse properly governance matters concerning the entities in which they invest on behalf of the Board. In exercising its ownership rights, the Board will rely in large part on its managers' recommendations and assure itself, where possible, that the relevant issues have been considered. As part of its manager selection process the Board will consider the extent to which the manager is managing effectively financial risks and opportunities that may arise from ESG issues (where relevant to the manager's investment strategy) and any ownership rights delegated to the manager.

1.3. Private Markets

In private markets, the Board will review the governance arrangements of an investment vehicle before committing capital. The Board will seek appropriate information, engagement, enforcement and termination rights and will ensure its interests are effectively represented through appropriate active representation on the vehicles' governance bodies. The Board will oversee the quality of the governance of the underlying assets held through those vehicles either through its managers or directly as appropriate.

1.4. Public Markets

In public markets the Board will exercise its voting rights and, recognising the value of focussed dialogue with company management, board and relevant fiduciaries (or their equivalents), to influence outcomes, it will, either through its investment managers or directly, pursue this approach where deemed appropriate. Where the Board believes it more efficient and effective to communicate a perspective in conjunction with other investors it will consider this option. Where warranted it will communicate its position publicly and assist regulatory authorities to improve overall protection of shareholder rights.

Following due consideration of the views of the relevant external investment managers, the Board's voting principles, Agency research and, where appropriate, other advisory services, ownership rights in the listed equities of Australian companies are exercised by the Agency on behalf of the Board. As appropriate the Agency will engage, generally through its external managers, with companies to clarify issues relating to resolutions and to ensure that it is sending clear and constructive signals through its ownership activities.

The exercise of ownership rights in the global (ex Australia) listed equities portfolio is delegated to the Future Fund's external investment managers. The approach of external investment managers to the exercise of ownership rights on behalf of their investors is assessed as part of the due diligence process prior to the appointment of a manager. The exercise of those rights is subject to close oversight by the Agency and regular reviews of the managers' ownership policies and practices. The Board retains the right to override managers and determine voting decisions, although in the normal case, it does not expect to have to do so.

The Board has developed high-level principles to help guide voting on resolutions put to shareholders. They are based on the premise that a corporation's actions should be consistent with the primary objective of generating long-term shareholder value. The principles are:

- i) **Companies should disclose relevant and material information on a timely basis to allow shareholders to make informed decisions.** The highest quality international accounting and financial reporting standards should be used and an annual audit should provide an objective external opinion that the financial statements fairly represent the financial position and performance of the entity and are in compliance with applicable laws and regulations. Boards should ensure the corporation complies with a widely recognised national corporate governance compliance code and are responsible for ensuring the corporation conducts its business with integrity;

- ii) **Companies should respect shareholder rights and consult shareholders on major decisions.** Major corporate changes, which in substance or effect may impact shareholder equity or erode share ownership rights, should be submitted to a vote of shareholders. Sufficient time and information (including a balanced assessment of relevant issues) should be provided to shareholders to enable them to make informed judgments on these resolutions. The Board will not generally support a proposal if there is not sufficient information disclosed in order to make an informed decision;
- iii) **All shareholders should be treated equally and have the right to vote in proportion to their economic interest in the company.** Any deviation from this general principle should be examined taking into account economic return;
- iv) **Boards should be fit for purpose.** Companies should exhibit sound and robust corporate governance by proposing high-calibre, commercially experienced and diverse boards of directors to provide superior business leadership and integrity. Suitably detailed information on existing and prospective board members should be made available together with policies on nomination and appointment arrangements to assist owners make informed judgements about candidates;
- v) **Boards of directors should be composed to allow the exercise of objective independent judgment on corporate affairs.** Directors must be accountable to shareholders and demonstrate skills and commitment to creating shareholder value and taking action, including on compensation arrangements, that are in line with shareholders interests;
- vi) **Companies should establish a sound system of oversight, management and control of business risks.** These include: operational, strategic, financial, legal and regulatory compliance, governance, reputational, employee relations, environmental and social risks;
- vii) **Boards should appropriately balance measures to protect the capital adequacy of the company with equitable treatment of shareholders.** Proposals relating to the capital structure of a company should balance the need to ensure adequate capital to protect its financial position and achieve its strategic objectives against the need to protect all shareholders' interests;
- viii) **Structures that transfer power from shareholders to management to protect against takeovers are generally undesirable.** The introduction of any such measures should be subject to shareholder vote and structured to give shareholders the ultimate decision on any proposal or offer; and
- ix) **Companies should have appropriate performance evaluation and incentive systems.** Performance related payments should be aligned with shareholders' interests by being linked to continuous productivity improvement giving rise to growth in earnings and dividends.

While the above principles are not exhaustive, and may not necessarily represent how voting will occur in any particular situation, they address (either individually or in combination with each other) the typical issues that are put to shareholders globally to vote upon.

1.5. Excluded investments

The Board may invest in any entities and assets where it is lawful do so subject to applicable laws, including the Board's own legislative constraints under the Future Fund Act 2006 (Cth), the Nation-building Funds Act 2008 (Cth) and the associated Investment Mandates given to the Board by the responsible Ministers. The Board in turn requires its investment managers to comply with applicable laws in connection with their investment activities on behalf of the Board.

Where it comes to the attention of the Board that an investment in any entity or relevant funding activity may be unlawful the relevant investment will be excluded or removed from the portfolio. There are also circumstances where the activities of an entity or relevant funding activity may be lawful in the relevant jurisdiction but the Board may nevertheless exclude or remove an investment from the portfolio having considered the issues set out in the following two paragraphs.

Australia has ratified a number of international conventions and treaties that limit certain activities. Where the Board becomes aware that the activities of an entity or funding activity may contravene such a convention or treaty, the Board will consider the exclusion or removal of the investment from the portfolio generally having regard to the nature of the limitations.

Having sought to influence the governance arrangements and behaviour, as set out above, through the exercise of its ownership rights (either through its managers or directly), the Board may assess that the entity is not responding appropriately. In these circumstances the Board may exclude the relevant investment from the portfolio.

1.6. Implementation and other considerations

The Board believes that it can play a role in advancing good practice for institutional investment, contributing to system integrity, protecting investor rights and building new markets. The Board believes that improving the stability, transparency and efficiency of the markets in which it operates will benefit the Future Fund as a long-term investor. This includes working with other market participants to encourage the proper use of ownership rights and to enhance governance arrangements.

The Board recognises that there may be challenges in assessing the matters addressed by this policy and in establishing definitive positions where information is incomplete or out of date. The Board takes a reasonable and pragmatic approach to these issues and will draw on the perspectives of its investment managers, its voting principles, external research, peer investors' practices and a range of other factors in forming its views.

The Board will regularly review its policies in relation to the exercise of ownership rights and ESG risk management and will refine and develop the implementation of these policies over time.

1.7. Reporting

The Board will disclose, in its annual report, the extent to which it exercised its ownership rights and, in broad terms, the nature of its voting.