futurefund

Responses to questions received from the Finance and Public Administration Legislation Committee in relation to the Government Investment Funds Amendment (Ethical Investments) Bill 2011

1. Does the Future Fund's Environmental, Social and Governance Framework and Statement of Investment Policies apply to all its subsidiaries and other vehicles?

The policy is broadly-based and designed to apply across subsidiaries and external investment managers.

2. Please list current investments in companies (and the countries in which those investments are made) that would be prohibited by the Bill if passed, including whether any derivatives are held. Please include in the list, and separately identify, investments by subsidiaries or other vehicles of the Future Fund.

In relation to the prohibitions contained in 20A(3)(a), (b), (c) and the similar provisions relating to the Nation-building Funds:

Manufacture tobacco products

The Global industry Classification Standard (GICS) is an industry classification standard developed by Standard and Poor's and MSCI Barra. GICS has a sub-industry category for manufacturers of tobacco products. The Future Fund's holdings of companies with this code that are in the MSCI All Countries World Index are detailed below. This will not identify companies that manufacture tobacco products but are classified under other categories.

It is unlikely that there are investments in companies that manufacture tobacco products within the Future Fund's private equity, property or infrastructure and timberlands programs. We have not identified any direct derivative exposures to the companies below. It is possible that the portfolio has exposure to tobacco companies through strategies using co-mingled funds, but this is not readily identified.

Future Fund – listed equity as at 30 June 2012

Body corporate	Country	AUD million
Altria Group	United States	2.201
British American Tobacco	Malaysia	1.971
British American Tobacco	United Kingdom	55.381
CIA Souza Cruz	Brazil	5.799
Gudang Garam TBK	Indonesia	2.344
Imperial Tobacco	United Kingdom	1.200
ITC GDR	India	0.044
ITC	India	9.659
Japan Tobacco	Japan	18.319

KT&G Corporation	Republic of Korea	14,839
Lorillard Inc	United States	48.539
Philip Morris Intl	United States	44.855
Philip Morris (Cz)	Czech Republic	0.191
Reynolds American Tobacco	United States	4.705
Swedish Match	Sweden	0.264

We have not identified any Future Fund holdings in the debt of the above companies. We have not identified any Nation-building Fund holdings in the listed equity or the debt of the above companies.

All the above holdings are held directly by the Board, not through subsidiaries or other vehicles.

Produce components for cluster munitions

There is no GICS classification standard for entities that produce components for cluster munitions. Investors globally who have considered this or broadly similar issues have formed different views on what constitutes a component or a component producer and the level of evidence and materiality required to help determine this. Accordingly, it is not possible to identify the companies that would be prohibited by the Bill.

As referred to in Question 4, under its policy the Future Fund has excluded certain companies on the basis of the Convention on Cluster Munitions or the Mine Ban Treaty and sought to apply a clear definition and rigorous research process in its assessment, while recognising the difficulties of doing so.

Produce, maintain or simulate nuclear weapons

There is no GICS classification standard for entities that produce, maintain or simulate nuclear weapons. Investors globally who have considered this or broadly similar issues have formed different views on what constitutes the production, maintenance or simulation of nuclear weapons and the level of evidence and materiality required to help determine this. Accordingly, it is not possible to identify the companies that would be prohibited by the Bill.

We have reviewed the exclusions applied by four institutional investors (Sweden's Sjunde AP-fonden, also known as AP7, The (Norwegian) Government Pension Fund Global, New Zealand Superannuation Fund and Pensioenfonds Zorg en Welzijn, the default occupational pension fund for the public healthcare sector in the Netherlands) that exclude companies on the basis of alleged involvement in the nuclear weapons industry (the definition of which varies from one investor to another). Only one company is excluded by all four investors, seven are excluded by three of them, six are excluded by two of them and 16 are excluded by only one of the four investors.

The companies identified by these other investors are typically broadly diversified organisations with a wide range of operating businesses and interests are held by investors for a variety of investment reasons.

Other prohibitions and making provision for socially responsible investment practices

In the absence of Ethical Investment Guidelines from the responsible Ministers as proposed by the Bill, it is not possible to identify what other bodies corporate may be prohibited by the Bill under 20A(2)(a) or 20A(2)(b).

3. What rates of return have been obtained by the Future Fund on investments in companies involved with items that would be prohibited by the Bill. Please list individual companies if possible, if not, please provide a weighted average return (or other relevant measure of return if it is more easily available) for each of the items that would be prohibited by the Bill? Please include in the list, and separately identify, investments by subsidiaries or other vehicles of the Future Fund.

Based on the response to question 2, the rates of return on investments in companies involved in the manufacture of tobacco products are provided below to 30 June 2012.

Body corporate	Inception to date (annualised)
Altria Group	12.1%
British American Tobacco Malaysia	9.3%
British American Tobacco UK	8.3%
CIA Souza Cruz	28.4%
Gudang Garam TBK	50.8%
Imperial Tobacco	(1.3%)
ITC GDR	11.7%
ITC	16.9%
Japan Tobacco	1.0%
KT&G Corporation	(6.0%)
Lorillard Inc	16.7%
Philip Morris Intl	15.7%
Philip Morris (Cz)	(8.0%)[1]
Reynolds American Tobacco	9.3%
Swedish Match	17%

All returns are in AUD terms

Inception date varies by stock.

[1] Held for less than one year

Noting the response to question two, it is not possible to provide rates of return in relation to entities that produce cluster munition components or produce, maintain or simulate nuclear weapons.

4. What rates of return were obtained by the Future Fund on investments in companies involved in cluster bombs and mines prior to them being divested. Please list individual companies if possible, if not please provide a weighted average return (or other relevant measure of return if it is more easily available)? Please include in the list, and separately identify, investments by subsidiaries or other vehicles of the Future Fund.

Body corporate	Rate of return AUD annualised
Alliant Techsystems[1]	(0.3%)[2] (20.8%)
General Dynamics	(4.1%)
Hanwha	(48.9%)
Kaman	Not invested
L-3 Communications	(9.0%)
Lockheed Martin	(7.4%)
Poongsan Corp[1]	(19.1%)[2] 41.1%
Raytheon	(4.2%)
ST (Singapore Technologies)	0.3%
Textron	(52%)

[1] As part of normal investment activities, stocks were traded based on commercial considerations. The rate of return is provided for each period in which the stock was held.

[2] Held for less than one year and so the return has not annualised.

All the above holdings were held directly by the Board, not through subsidiaries or other vehicles.

5. Do any of the fund managers appointed by the Future Fund have policies excluding the investment in companies involved with items that would be prohibited by the Bill?

Fund managers invest according to the specific instructions of their clients and apply the policies required of them. These clients have a variety of approaches to exclusions with some applying exclusions and others not.

6. The February 2012 Future Fund's Statement of Investment Policies, states that '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.'

> **a. What risks (including reputational risks) have been identified in relation to the investment in companies involved with items that the Bill would prohibit?**
>
> **b. How have those risks been managed to date for the investments in companies involved with items that the Bill would prohibit?**

The Future Fund has said that 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. It has said that it will consider international treaties and conventions, ratified by Australia, that limit certain activities having regard to the nature of the limitations. In light of its policy the Board decided to divest any holdings in entities that manufactured cluster munitions systems or land mines.

External investment managers are responsible for considering the specific risks in relation to investment in individual companies as part of their investment decision-making process and the Fund incorporates an assessment of the investment decision making process and alignment with the Fund's investment policies and approach as part of its manager selection and monitoring processes.

7. Has the board previously considered divesting the investments in the companies involved with items that the Bill would prohibit and if so, what were the reasons for not divesting?

The Board considers the extent to which its investments are consistent with its policies through an ongoing process. In 2009 and 2011, the Board's policy led it to divest from, and exclude ex ante a number of companies involved in the production of cluster munitions or landmines.

The Board has considered whether other divestments are required under its policy and has not excluded any other companies.

8. For the investments in companies involved with items that the Bill would prohibit, please provide an estimate of what proportion of the ownership rights are held by the Future Fund and what proportion are held by others, e.g. investment managers?

The Board currently owns up to 0.3% of the common stock of each body corporate that manufactures tobacco products, as identified in question 2.

As per question 2, it is not possible to provide data in relation to body corporates that produce components for cluster munitions or that produce, maintain or simulate nuclear weapons.

9. If the Bill were passed, would any ownership rights delegated to investment managers also be covered?

We understand the Bill to mean that if the Future Fund holds a prohibited financial asset, it would be required to divest it. Upon divestment ownership rights, whether delegated to investment managers or exercised by the Board, would cease and the Board would essentially have no capacity to influence governance or behaviour. It is expected that any requirements on ownership rights covered by the Bill would be delegated to managers, where relevant.

10. The Future Fund Annual Reports list performance bonuses that have been paid to Future Fund agency staff. Have any staff in receipt of bonuses been involved (such as making recommendations to acquire an investment) with the decisions to acquire investments in companies involved in the items that the Bill would prohibit?

a. If so, please list the investment, its value, the prohibited item and the bonus?

No. Investment decisions in respect of individual companies are made by external investment managers.

11. The February 2012 Future Fund's Statement of Investment Policies, section 7 on ownership rights and ESG management states that '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.' How would the board ensure that its managers and subsidiaries or other vehicles comply with the Bill if it were passed?

The Future Fund uses a range of contractual, policy, monitoring and reporting arrangements to apply the Board's policies in the manner appropriate for the broad range of strategies and structures used.

How the Board would apply the requirements of the Bill would depend on the final form of any legislation or Guidelines.

12. Does the Future Fund or any of its subsidiaries or other vehicles have any investments in companies involved with gambling? If so, what are the amounts invested in each company?

Portfolio exposure to Australian equities means that the Future Fund has invested in Australian listed public companies such as Aristocrat Leisure, Crown Limited, Echo Entertainment Group, Tabcorp Holdings and Tatts Group which are classified in the casinos and gaming industry. There may be other publicly listed Australian companies in the portfolio, such as Woolworths and Coles, 'involved with gambling', depending on how widely that is construed. There would also be exposure to entities 'involved in gambling' overseas. While the Bill does not directly refer to entities 'involved in gambling', if it is intended that the Bill be directed towards this, we would need guidance on the definitions to be used.

13. Has the International Forum of Sovereign Wealth Funds considered adjusting its guidance principles to discourage investment in companies involved with the items that the Bill would prohibit?

No, the Generally Accepted Principles and Practices (the Santiago Principles) for sovereign wealth funds do not seek to discourage investments on the grounds identified in the Bill.

14. Would the provisions of the Bill prohibit subsidiaries or other vehicles of the Future Fund from investing in companies involved with the prohibited items identified in the Bill?

The Future Fund would apply the provisions of the Bill to its portfolio using a range of contractual, policy, monitoring and reporting arrangements to implement its requirements. The broad nature of the Bill's provisions and the complexities involved in applying the provisions may lead the Fund to need to terminate or avoid certain strategies in order to meet the Bill's provisions.

15. What proportion of the Future Fund's assets are invested in its subsidiaries altogether, and in the subsidiaries based in the following locations?
a. Cayman Islands;

b. Luxembourg;

c. British Virgin Islands; and

d. Jersey

The Future Fund invests through various jurisdictions and investment vehicles for a variety of commercial, legal and tax reasons (refer p. 36 of the 2010/11 Annual Report). Properly structuring its investments can be essential to maintaining the Board's rights and entitlements including the benefit of sovereign immunity for tax purposes in certain jurisdictions.

Failure to manage these matters can have a material financial impact on performance and would be inconsistent with the mandated objective to maximise returns without excessive risk and fail to reflect the Board's obligation not to cause any diminution of the Australian Government's reputation in financial markets.

The Future Fund will only invest through arrangements and structures that are commonplace and well tested by other public investment institutions and funds in terms of compliance with applicable laws and regulations.

The Future Fund does not invest in schemes that contravene the OECD's key principles of transparency and information exchange for tax purposes. It only invests through jurisdictions that are regarded by the OECD as having substantially implemented the internationally agreed tax transparency standard. The Board ensures that operational, legal, financial and taxation due diligence is undertaken as part of the investment decision making process and that appropriate ongoing monitoring of mandate compliance and investment performance is undertaken.

As at 30 June 2012:
18.3% of the Future Fund's assets are invested through subsidiaries of the Board of Guardians

a) 14.4%
b) 0%
c) 0.7%
d) 0.6%

To avoid double counting, assets have been consolidated and reported in line with the approach used in the 2010/11 annual report.

16. What proportion of the Future Fund's assets are invested in its other vehicles in which it does not have a controlling interest (e.g. as described on page 63 of the 2010-11 annual report) altogether, and based in the following locations?

a. Cayman Islands;

b. Luxembourg;

c. British Virgin Islands; and

d. Jersey

The Future Fund invests through various jurisdictions and investment vehicles for a variety of commercial, legal and tax reasons (refer p. 36 of the 2010/11 Annual Report). Properly structuring its investments can be essential to maintaining the Board's rights and entitlements including the benefit of sovereign immunity for tax purposes in certain jurisdictions.

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As at 30 June 2012:
19.7% of the Future Fund's assets are invested through private market vehicles which are not subsidiaries

a) 9.8%
b) 0.1%
c) 1.7%
d) 1%

To avoid double counting, assets have been consolidated and reported in line with the approach used in the 2010/11 annual report

17. The 2010-11 Future Fund annual report on page 72 indicates a substantial increase in audit fees for auditing its subsidiaries – what is the cause of the increase?

The increase in audit fees reflects the increase in the number of subsidiaries from 29 subsidiaries at 30 June 2010 to 69 subsidiaries at 30 June 2011.