INQUIRY INTO THE GOVERNMENT INVESTMENT FUNDS AMENDMENT (ETHICAL INVESTMENTS) BILL 2011

SUBMISSION FROM OXFAM AUSTRALIA

SENATE FINANCE AND PUBLIC ADMINISTRATION LEGISLATION COMMITTEE

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1 Introduction

Oxfam Australia

Oxfam Australia is an independent, not-for-profit, secular international development agency. We are a member of Oxfam International, a global confederation of 17 Oxfams that work with others to overcome poverty and injustice in 92 countries around the world. Oxfam Australia's vision is of a fair world in which people control their own lives, their basic rights are achieved, and the environment is sustained.

Oxfam Australia has worked with local communities around the world to combat poverty and injustice for over 50 years. We support more than 400 long-term development projects in 30 countries across Africa, Asia, the Pacific and Indigenous Australia. Oxfam Australia undertakes long-term development projects, provides emergency response during disaster and conflict, and undertakes research and advocacy for policy and practice changes which promote human rights and justice.

Oxfam Australia, along with our Oxfam colleagues across the world, has specific expertise in the corporate sector including corporate accountability and responsible investment practices.

Oxfam Australia holds full accreditation status with AusAID, the Australian Government's Agency for International Development, and is a signatory to numerous industry codes of practice including the Australian Council for International Development (ACFID) Code.

The Government Investment Funds Amendment (Ethical Investments) Bill 2011

Oxfam Australia is broadly supportive of the Government Investment Funds Amendment (Ethical Investments) Bill 2011. This Submission outlines our reasoning for this support, and also provides further recommendations as to amendments to this Bill which we believe will improve its efficacy in incorporating responsible investment practices in the approach of the targets specified within the Bill.

2 Summary of recommendations

The following is a summary of the recommendations submitted by Oxfam Australia to the Inquiry into the Government Investment Funds Amendment (Ethical Investments) Bill 2011 ("**The Bill**"). The recommendations are explained in full throughout the remainder of this submission.

Recommendation 1: Change all references in the Bill from 'Ethical' or 'Socially Responsible' Investments or Guidelines to 'Responsible Investment', to more accurately reflect the investment process put forward under the Bill, and align this investment process with international norms and practices.

Recommendation 2: That the Senate Committee recognize that Responsible Investment is:
- compatible with the legal obligations of the Target Funds;
- essential to the risk management of the Target Funds; and
- offers competitive returns in the short-term and more sustainable returns in the longer-term.

Recommendation 3: That the Senate Committee recognize that Responsible Investment is the best practice approach for the Target Funds as Australia's Sovereign Wealth Funds:
- given their role as 'universal investors';
- the need to take a precautionary approach towards the likelihood of additional obligations imposed on Sovereign Wealth Funds through State Responsibility under international legal norms; and
- that clarity of non-partisan investment practice of a Sovereign Wealth Funds is best delivered through public adoption of a Responsible Investment policy which adheres to international norms.

Recommendation 4: That the Bill be amended to make explicit connection between the focus of the investment objective for the Target Funds and environmental, social and governance considerations. Such an amendment could follow the precedent from the Guidelines for the Norwegian Global Pension Fund which state that "The management of the assets in the Fund shall be based on the goal of achieving the highest possible return. A good return in the long term is dependent on sustainable development in economic, environmental and social terms, as well as well-functioning, legitimate and effective markets."

Recommendation 5: That the Bill be amended to provide for an independent Authority or Process which can make specific recommendations to the Target Fund's Guardians on exclusion or negative screening of investments.

Recommendation 6: That the Bill be amended to require that the Responsible Investment Guidelines developed by the Ministers responsible for the Target Funds integrate implementation of Responsible Investment methods particularly - proscription or negative screening, company engagement and positive investment.

Recommendation 7: That the Bill be amended to require that the Responsible Investment Guidelines developed by the Ministers responsible for the Target Funds include provision for ongoing transparency and reporting of Responsible Investment policy and decisions, including an obligation to specifically on measures taken to implement the Responsible Investment practices outlined by the Guidelines.

3 What is Responsible Investment?

Responsible Investment is a more appropriate term than 'ethical investment'.

The Explanatory Memorandum to the Bill notes its introduction aims to constrain the investments of government investment funds created by the Future Fund Act 2006 and the Nation-building Funds Act 2008 ("**the Target Funds**"), to those investments which are "*...consistent with socially responsible investment practices*".

The preferred term for these types of socially responsible, or 'ethical' investment practices is 'Responsible Investment'. Responsible Investment is widely used both in Australia, and in international practice to describe an investment process which takes environmental, social, governance ("**ESG**") or ethical considerations into account.[1] This process stands in addition to, or is incorporated into the usual fundamental investment selection and management process. From our reading of the Bill and its explanatory documents, its aim is therefore better described as requiring the Target Funds to apply 'Responsible Investment' Practices.

The reason for the preference is not simply the widely accepted use of the term Responsible Investment in global investment practice. Responsible Investment uses an internationally recognized and broader range of tools for applying its principles to investment screening as compared ethical or socially responsible investment. Furthermore, Responsible Investment has been codified in international norms, such as the United Nations Principles for Responsible Investment,[2] which provides actors seeking to introduce Responsible Investment with certainty and a greater level of non-partisan transparency in its application.

Recommendation 1: Change all references in the Bill from 'Ethical' or 'Socially Responsible' Investments or Guidelines to 'Responsible Investment', to more accurately reflect the investment process put forward under the Bill, and align this investment process with international norms and practices.

[1] See the Responsible Investment Association of Australasia Website www.responsibleinvestment.org
[2] See www.unpri.org

Methods of Responsible Investment

Responsible Investment screening methods can broadly fit into 3 categories: Criteria for screening investments which focuses on ESG risk; Engagement with investment targets on ESG issues; and Positive Investment towards those sectors deemed more secure investment destinations based on ESG factors. Selection of the Responsible Investment screening methods applicable in a specific situation depends upon both the intention of the selectee and the type of investment sought. Therefore, an Investment Bank, a suburban investment advisor and an Industry Superannuation Fund would all use a different combination of Responsible Investment methods.

Outlined at Section 7 of this submission are Oxfam's recommendations for the Responsible Investment screening methods that are most applicable to the Target Funds, which should be incorporated into the Bill.

4 Why should investors utilise Responsible Investment?

As investors, the Target Funds seek what most investors seek - the best returns over the course of their investments. Prior to, and most especially following the Global Financial Crisis, it has been recognised that environmental, social and corporate governance (ESG) issues affect the performance of investment portfolios (to varying degrees, across companies, sectors, regions, asset classes and through time). It is therefore necessary to incorporate such issues into investment-analysis and decision-making as a matter of course. Responsible Investment has developed in light of this recognition, and its incorporation into the investment practices of the Target Funds through this Bill will see Australia again at the forefront of best-practice in the financial and investment sector.

In Oxfam's experience, misconceptions abound in relation to Responsible Investment. Outlined below is a more detailed explanation of its benefits.

Responsible Investment is compatible with the legal obligations of the Target Funds

A common misconception is that Responsible Investment may be incompatible with existing legal obligations (often classed as fiduciary duties) for the investment sector.[3] These Fiduciary duties include the central obligation on the fund manager or other person who is the trustee of the investment portfolio to use his/her discretionary powers to **act in the best interests** of the portfolio's beneficiaries (the asset owners) in a relationship of trust and confidence.[4] In 2005, the UN Environment Programme Finance Initiative (UNEPFI) commissioned a report by Freshfields Bruckhaus Deringer ("**FBD**") to specifically address the issue of whether taking ESG issues into account in investment decisions was permissible, legally required, or hampered by

[3] See Anita Halvorssen, "Using the Norwegian Sovereign Wealth Fund's Ethical Guidelines as a model for Investors", University of Oslo Faculty of Law Legal Studies Research Paper Series No. 2011-08. Electronic copy available at: http://ssrn.com/abstract=1774748

[4] This definition comes from the Freshfields Bruckhaus Deringer Report (see the following footnote for full reference), but is also reflected in Australian investment law.

law and regulations.[5] The FBD report states that "[T]*here is no duty to 'maximize' the return of individual investments, but instead a duty to implement an overall investment strategy that is rational and appropriate to the fund*." It concluded that, contrary to the-then commonly held view, ESG considerations are indeed permissible to consider.[6]

Responsible Investment is essential to the risk management of the Target Funds

The FBD Report went one step further than finding that ESG considerations were compatible with existing investment legal and regulatory obligations. It found that they are *required to be taken into account*, if there is the potential for the ESG elements to have a material and financial impact on the performance of the investment.[7]

There is growing recognition that ESG elements do in fact have a sufficient material and financial impact on a company's performance, such that ESG issues have become risk factors for asset owners and asset managers worldwide. As David Bradbury, Australian Parliamentary Secretary to the Treasurer said in his address to the Macquarie Securities Annual ESG Conference on 14 November 2011, "*A company at odds with the local, regional or global community with which it interacts will always carry risk*."[8] For any portfolio management, risk is the most important issue, in this respect, as flagged by the FBD Report, the Target Funds have an obligation as a part of their fiduciary duty, to take ESG considerations into account when assessing risk.

Responsible Investment offers competitive returns in the short term, and better returns in the longer-term

Responsible investment does not necessarily entail any irresolvable trade-offs between financial and socially responsible goals. In the immediate term, countervailing business motivations to fund irresponsible behaviour certainly can prevail because of underlying market and regulatory failures, or because investors perceive no financial value in ESG assets such as water sources, or a social 'licence to operate', or responsible corporate governance, if they cannot be immediately monetised.[9] In the longer-term, the economic case for responsible investing solidifies. The Responsible Investment Association of Australasia outlines in considerable detail each year, the competitive performance of Australian funds using Responsible Investment practices as compared to funds using conventional investment metrics.[10] This competitive performance increases over time into *better* performance, as found by other international studies, such as that undertaken recently in Canada[11] which found that in the Canadian Equity fund class, the average of Responsible Investment funds outperformed the average of all Canadian Equity

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[5] Freshfields Bruckhaus Deringer, 'A legal framework for the integration of environmental, social and governance issues into institutional investment' 3 (2005). Commissioned by the UN Environment Program Finance Initiative (UNEPFI)

[6] Freshfields Bruckhaus Deringer Report, supra note 56 at 105.

[7] Id. at 5 and 14.

[8] David Bradbury, Australian Parliamentary Secretary to the Treasurer, 'Lining up community expectations and corporate practice in the social and governance areas', Address to the Macquarie Securities Annual ESG Conference, Sydney, 14 November 2011., N.018.

[9] Richardson, Benajmin J., 'Keeping Ethical Investment Ethical: Regulatory Issues for Investing in Sustainability," Journal of Business Ethics (2009) 87(4): 555, 556-557.

[10] See www.responsibleinvestment.org

[11] http://www.socialinvestment.ca/documents/SRI_Funds_Perform_Strongly_SIO_2012.pdf

funds on a one, three, five and ten-year basis. Eleven of the fifteen funds in this category outperformed the industry average on a one-year basis, six of nine outperformed on a three-year basis, five of eight outperformed on a five-year basis and all four out of four outperformed on a ten-year basis.

The Target Funds on which this Bill is focused are explicitly focused on the longer-term, given their objective to strengthen the Australian Government's long term financial position by making provision for unfunded Commonwealth superannuation liabilities.[12] Given this focus, more so than even other investment funds, Responsible Investment offers the Target Funds an opportunity to ensure solid and sustainable returns.

Recommendation 2: That the Senate Committee recognize that Responsible Investment is:
- compatible with the legal obligations of the Target Funds;
- essential to the risk management of the Target Funds; and
- offers competitive returns in the short-term and more sustainable returns in the longer-term.

5 Why should Sovereign Wealth Funds Responsibly Invest?

As outlined above, the longer-term nature of the Target Funds' investment horizon particularly suits a Responsible Investment approach. As the Target Funds operate as Australia's Sovereign Wealth Funds,[13] there are also other aspects of their functioning which make the Target Funds a particularly good fit for Responsible Investing.

What are Sovereign Wealth Funds?

In their governance, formally Sovereign Wealth Funds (SWF) are public institutions but functionally they are generally expected to be private actors.[14] They invest large pools of state-owned assets in the market to meet macro-economic policy objectives,[15] such as to buffer the

[12] See www.futurefund.gov.au
[13] For a further explanation of Sovereign Wealth Funds see International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds, Generally Accepted Principles and Practices: Santiago Principles (October 2008), available at http://www.iwg-swf.org/pubs/gapplist.htm
[14] Richardson, Benjamin J., 'Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand,' Nordic Journal of Commercial Law, Issue 2011#2., p.1
[15] Blundell-Wignall, Adrian., Hu, Yu-Wie., and Yermo, Juan., 'Sovereign Wealth Fund and Pension Fund Issues,' OECD Working Papers on Insurance and Private Pensions (2008) 14:4.

state's budget and economy against swings in international markets, or to build savings to meet future financial burdens such as pension payments.[16] SWFs are typically funded through either commodity-based earnings, such as from a country's natural resources sector, or by noncommodity-based resources, such as foreign exchange reserves and general taxation revenue.[17]

Such concentration of wealth has made Sovereign Wealth Funds, an institutional phenomenon that began in the mid-1950s, influential actors in the global economy.[18] According to the Sovereign Wealth Fund Institute, as of May 2011 there were 52 Sovereign Wealth Funds worldwide, with assets of some US$4.3 trillion.[i] A recent survey by the Monitor Group, published in July 2011, put Norway's Sovereign Wealth Fund (which utilises Responsible Investment) as the largest with US$560 billion in assets.[19] With Sovereign Wealth Fund assets expected to at least double within the next decade,[20] and growing awareness of their economic clout and capacity to project state political power, international efforts to create voluntary behavioural codes for such funds have grown. The principal achievement to date is the Santiago Principles,[21] which allow for Responsible Investing, and emphasise transparency, clarity, and equivalent treatment with private funds similarly operated.

In Australia's case, the Target Funds outlined in the bill are accepted as Sovereign Wealth Funds, and Australia was particularly involved in the creation of the Santiago Principles.

As 'universal owners' Sovereign Wealth Funds should prioritise Responsible Investment

As outlined by Professor Benjamin J. Richardson,[22] for large institutional investors, including Sovereign Wealth Funds (SWF), the imperative towards Responsible Investment is best understood through the concept of the "universal owner."[23] Essentially, this means the SWFs are institutional investors who invest widely across the market. As economy-wide investors, their interest lies in the effective functioning of the market in its totality, and they therefore have little interest in supporting behaviour by any one company or sector that yields a short-term benefit while threatening harm to the economic system as a whole. Furthermore, universal

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[16] Richardson, Benjamin J., 'Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand,' Nordic Journal of Commercial Law, Issue 2011#2., p.1

[17] Rumu Sarkar, "Sovereign Wealth Funds as a Development Tool for ASEAN Nations: From Social Wealth to Social Responsibility," Georgetown Journal of International Law (2010) 41: 621, at 623.

[17] Sovereign Wealth Fund Institute, http://www.swfinstitute.org.

[18] Rumu Sarkar, "Sovereign Wealth Funds as a Development Tool for ASEAN Nations: From Social Wealth to Social Responsibility," Georgetown Journal of International Law (2010) 41: 621, at 623.

[18] Sovereign Wealth Fund Institute, http://www.swfinstitute.org.

[19] Monitor Group, "SWF Assets Under Management" (7 July 2011), http://www.monitor.com/tabid/202/L/en-US/Default.aspx. In local currency, the NZSF valued its assets as NZS18.8 billion in March 2011 (see http://www.nzsuperfund.co.nz/index.asp?PageID=2145855927), while the NGPF-G valued its at NOK 3,007 trillion (Norges Bank Investment Management (NBIM), Annual Report 2010 (NBIM, 2010), 1).

[20] International Monetary Fund, "Norway's Oil Fund Shows the Way for Wealth Funds," IMF Survey Magazine: Policy (9 July 2008).

[21] see International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds, Generally Accepted Principles and Practices: Santiago Principles (October 2008), available at http://www.iwg-swf.org/pubs/gapplist.htm

[22] Professor and Canada Research Chair in Environmental Law and Sustainability, University of British Colombia in Richardson, Benjamin J., 'Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand,' Nordic Journal of Commercial Law, Issue 2011#2.

[23] This concept was pioneered by James Hawley and Andrew Williams in 'The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic,' University of Pennsylvania Press, 2000.

owners invest across sectors and asset classes. In that sense, they are exposed to any 'externality' at the level of an individual company that may result in a costly 'internality' for elsewhere in an investor's global portfolio. For example, research has begun to measure the cost of environmental externalities to universal investors. A report prepared for the UNPRI Secretariat evaluated the price of environmental damage worldwide to which the companies in a representative investment portfolio contribute, and estimated these in 2008 to be US$6.6 trillion or 11% of global GDP.[24] The report expects such costs by 2050 to grow to US$28.6 trillion (18% of projected global GDP), a cost that may be born elsewhere in the market – such as by host governments (affecting government bonds), by insurance companies (affecting investment in the insurance sector), or even by later incarnations of the contributing companies themselves. A failure to take into account ESG factors would result in these costs being ignored by a SWF, to greater cost somewhere in a universal portfolio at a later date.

The Norwegian Global Pension Fund Guidelines[25], reflects these notions of the "universal investor", in which long-term financial returns hinge on maintenance of healthy social, environmental and governance returns. Thus, while the Guidelines requires the Norges Bank to manage the Fund in order to achieve the "highest possible return,"[26] this objective is qualified as "dependent on sustainable development in economic, environmental and social terms [and] well-functioning, legitimate and effective markets."[27]

Sovereign Wealth Funds may have additional obligations to comply with international law and the obligations of host states

Issues of an investor's complicity for the activities of a company in which it has invested have become a more prevalent consideration under instruments like the OECD's Guidelines for Multinational Enterprises.[28] International consensus on corporate and financial complicity in violations of international law has forced private entities to be more aware of the political consequences of private economic activity.

Those obligations, and consequences, fall equally on states seeking to intervene in private markets under similar conditions. In fact, as noted earlier, formally Sovereign Wealth Funds are public institutions but functionally they are generally expected to be private actors. Such expectations fail to take into consideration that given their connection to the State, they could be held to an even higher level of obligation than truly private actors. For instance, in March 2002, Norway's then Petroleum Fund Advisory Commission on International Law concluded that, as there was "a large degree of probability" that a particular investment into a company which produced (through a subsidiary) anti-personnel mines, could constitute a violation of Norway's

[24] Principles of Responsible Investment (PRI) Association and UNEP-FI, 'Universal Ownership: Why Externalities Matter to Institutional Investors', PRI Association and UNEP-FI, 2010, p.2

[25] Guidelines for Norges Bank's Work on responsible Management and Active Ownership of the Government Pension Fund Global (2010), available at www.regjeringen.no

[26] Guidelines II, s.1(1)

[27] Ibid.

[28] See OECD's Guidelines for Multinational Enterprises (updated 2011), www.oecd.org, which are a part of the OECD Declaration and Decisions on International Investment and Multinational Enterprises.

obligations not to assist the production of anti-personnel mines under the Ottawa Convention on Anti-Personnel Mines.[29]

While this area of international law is insufficiently explored, and there is debate as to the extent to which SWF are direct or indirect organs of the state, a precautionary approach is prudent at this point. This precautionary approach has been demonstrated by the New Zealand SWF (The New Zealand Superannuation Fund), which is legislatively required to invest "...in a manner consistent with.... (c) avoiding prejudice to New Zealand's reputation as a responsible member of the world community."[30] As such, the Act attempts to keep at the forefront of the investing strategy the connection (both legally and through perception) between the activities of the SWF and the role and obligations of the host state. By explicitly providing for Responsible Investment, these issues will therefore be transparently considered by the Target Funds during the investment screening process itself.

Clarity of non-partisan investment practice of a Sovereign Wealth Funds is best delivered through public disclosure of a Responsible Investment policy which adheres to international norms

A concern in relation to SWF in general has traditionally been the extent to which they could function as political or partisan arms of a state in financial markets. The Santiago Principles[31] of the International Working Group of Sovereign Wealth Funds attempt to address this by imposing requirements for transparency and disclosure of investment decision making. For instance at GAPP 19.1 they state that, "If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed." Such an approach prefers an up-front, publically disclosed Responsible Investment policy to an ad-hoc investment strategy imposing ESG factors inconsistently and privately by the investment managers of a SWF. As such, this Bill provides the transparency and clarity required by the Santiago Principles of Australia's SWF.

Furthermore, in the imposition of an ad-hoc ESG approach without a clear legislative directive, issues are liable to be taken up by governments of the day in an inconsistent and politically partisan matter. By seeking to restrain the consideration of these factors to the internationally accepted norms of 'Responsible Investment', this Bill provides the Target Funds with certainty and predictability when undertaking investment screening.

There is international precedent for Responsible Investment by Sovereign Wealth Funds

[29] See The Petroleum Fund Advisory Comm'n on International Law, Memorandum to the Ministry of Finance: Question of Whether Investments in Singapore Technologies Engineering Can Imply a Violation of Norway's International Obligations (Mar. 22, 2002), http://www.regjeringen.no /en/dep/fin/Selected-topics/andre/Ethical-Guidelines-for-the-Government-Pension-Fund---Global-/Advisory-Commission-Documents/Advisory-Commission.html?id=413581

[30] New Zealand Superannuation and Retirement Income Act of 2001, section 58(2)(c).

[31] International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds, Generally Accepted Principles and Practices: Santiago Principles (October 2008), available at http://www.iwg-swf.org/pubs/gapplist.htm

Since 2000, the SWF of Sweden, Norway, New Zealand and France have been subject to legislative direction to invest Responsibly. Most commentators have focused upon the activities of the Norwegian and New Zealand SWF, as such this Submission largely restricts its use of examples to these two funds.

As outlined earlier, Norway's Sovereign Wealth Fund, is the world's largest - with US$560 billion in assets.[32] The performance of Norway's Fund (The Norwegian Government Pension Fund – Global) is demonstrative for the purposes of the Inquiry into this Bill. Firstly, while some commentators criticised that "the process supporting the ethical mandate actually constrains the fund's functional efficiency," and that it "may pay a high price for its ethical policies over the long-term,"[33] these concerns have been shown to be unfounded. The Norwegian Fund achieved average annual returns in the decade since January 2000 of 3.02%, well above the government's expected benchmark investment performance of 2.40% per year.[34] Secondly, the Norwegian Fund is widely recognised as a remarkably transparent and well-governed financial institution. According to a global assessment in 2008 of Sovereign Wealth Fund Best Practices[35] the GPF-G scored 92 out of a possible 100 in terms of its adherence to best-practice. In doing so, it came second only to the Alaska Permanent Fund (which scored 94). By contrast, the average score across 34 non-pension funds was 46.

Recommendation 3: That the Senate Committee recognize that Responsible Investment is the best practice approach for the Target Funds as Australia's Sovereign Wealth Funds:

- *given their role as 'universal investors';*
- *the need to take a precautionary approach towards the likelihood of additional obligations imposed on Sovereign Wealth Funds through State Responsibility under international legal norms;*
- *and that clarity of non-partisan investment practice of a Sovereign Wealth Fund is best delivered through public adoption of a Responsible Investment policy which adheres to international norms.*

6 Fundamentals for Responsible Investment in this Bill

[32] Monitor Group, "SWF Assets Under Management" (7 July 2011), http://www.monitor.com/tabid/202/L/en-US/Default.aspx. In local currency, the NZSF valued its assets as NZS18.8 billion in March 2011 (see http://www.nzsuperfund.co.nz/index.asp?PageID=2145855927), while the NGPF-G valued its at NOK 3,007 trillion (Norges Bank Investment Management (NBIM), Annual Report 2010 (NBIM, 2010), 1).

[33] Gordon L. Clark and Ashby Monk, 'The Norwegian Government Pension Fund: Ethics over Efficiency', Rotman International Journal of Pension Management, 2010 p14. and Larry C. Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment', Georgetown Journal of International Law, 2010, p17.

[34] Norges Bank Investment Management, *NBIM Performance Results*, NBIM, 2010, no.8.

[35] Edwin M. Truman, A Blueprint for Sovereign Wealth Fund Best Practices, Peterson Institute Policy Brief No. PB08-3 (April 2008).

A best-practice approach to Responsible Investment in this Bill requires incorporation of the fundamental building blocks necessary to ensure the Target Funds are both drawing on international precedent, and that the Bill enshrines a broad and transparently utilisable investment approach for the Guardians of the Target Funds. Outlined below are Oxfam's recommendations for inclusion in the Bill to specify the set-up of the Target Funds' Responsible Investment framework.

Reframing the investment objective of the Targets Funds to explicitly outline Responsible Investment considerations.

As outlined in Section 5 and 6 of this Submission, Responsible Investment is not only essential to appropriate risk management of an investment portfolio, but particularly applicable to SWFs. In the example of both the SWF of Norway and New Zealand, this has been made clear by making explicit connection between the focus of the investment objective and ESG considerations. In the instance of the Norwegian Fund, the objective to achieve the "highest possible return,"[36] is qualified as "dependent on sustainable development in economic, environmental and social terms [and] well-functioning, legitimate and effective markets."[37]

Such an explicit reference provides clarity to both the broader investment market, and the investment managers of a Fund. As such, it is recommended that this Bill incorporate such a reference.

> *Recommendation 4: That the Bill be amended to make explicit connection between the focus of the investment objective for the Target Funds and ESG considerations. Such an amendment could follow the precedent from the Guidelines for the Norwegian Global Pension Fund which state that "The management of the assets in the Fund shall be based on the goal of achieving the highest possible return. A good return in the long term is dependent on sustainable development in economic, environmental and social terms, as well as well-functioning, legitimate and effective markets."*

Provision for an Independent Authority or Process which can make specific recommendations to the Target Fund's Guardians on exclusion or negative screening of investments.

Given the need for transparent decision making on Responsible Investment, as outlined above, international best practice demonstrates that Responsible Investment for a SWF is assisted through provision for an Independent Authority or Process which can make recommendations

[36] Norges Bank Guidelines II, s.1(1)
[37] Ibid.

to the SWF investment managers on Responsible Investment issues, particularly in relation to exclusion or negative screening of investments on the basis of Responsible Investment concerns. The Norwegian Sovereign Wealth Fund has a Council on Ethics which submits recommendations to investment decision-makers on exclusion of companies, recommendations about which the investment managers of the SWF can further assess to ensure compatibility with investment criteria. In assessing investments on these grounds, it relies not only on international treaties ratified by Norway, but also international norms and standards approved by Norway such as the UN Global Compact and the OECD Guidelines for Corporate Governance and for Multinational Enterprises. By contrast, the New Zealand Superannuation Fund lacks an independent process or council to provide input and advice. It is our submission that an Independent Authority or Process can assist the Guardians of the Target Funds in being provided with thorough and transparent recommendations as to Responsible Investment practices.

> *Recommendation 5: That the Bill be amended to provide for an independent Authority or Process which can make specific recommendations to the Target Fund's Guardians on exclusion or negative screening of investments.*

Allowing for the integrated implementation of Responsible Investment strategies particularly negative screening, company engagement and positive investment.

The Bill proposes proscribing investments by the Target Funds in companies involved in the manufacture of tobacco, cluster munitions, nuclear arms and other entities to be proscribed under Ethical Investment Guidelines. While such a proscription (also known as exclusion or negative screening) is a component of Responsible Investment, limiting the scope of Responsible Investment to solely proscription fails to allow the Guardians of the Target Funds to more innovatively and broadly pursue Responsible Investment methods. In fact, such a limitation is often responsible for the criticisms directed towards Responsible Investment in SWF[38], criticisms which are framed on a narrow and primarily exclusion-based approach to Responsible Investment.

Instead, as outlined in Section 3 of this Submission, Responsible Investment screening methods can broadly fit into 3 categories: Criteria for screening investments which focuses on ESG risk; Engagement (or 'Active Ownership') with investment targets on ESG issues; and Positive Investment towards those sectors deemed more secure investment destinations based on ESG factors. Utilising a combination of all 3 categories of Responsible Investment is the best means of retaining a properly diversified portfolio and to maximising influence on the investment market. Indeed, as the Norwegian SWF (which explicitly uses all 3 approaches) demonstrates, the use of all 3 strategies is not mutually exclusive. For instance, corporate engagement can occur in the lead-up to exclusion, and afterwards with beneficial results – in the Norwegian

[38] See "The Oxford University SWF Project – The Design and Governance of Sovereign Wealth Funds' at http://oxfordswfproject.com

SWF example - companies excluded by the Norwegian SWF have been re-admitted following action taken to address the ESG risks identified through the Responsible Investment process.[39]

In New Zealand, the utilisation of Engagement/Active Ownership strategies by the New Zealand Superannuation Fund ("**NZSF**") is having a positive impact. In 2008 the Guardians wrote to every company in the NZX 50 Index (NZ's premier stock market index) to encourage replies to 'Carbon Disclosure Project' disclosure requests. According to the Guardians, the response-rate increased to 50% from 38% in the previous year, partly as a result of the Fund's presence, and therefore providing information which the NZSF can use to more accurately assess risk of future carbon or climatic investment impacts.[40] Furthermore, the Guardians see their action as "important in raising awareness amongst NZ companies that investors globally are interested in the economic impacts of climate change and its potential effect on long-term shareholder value."[41]

> *Recommendation 6: That the Bill be amended to require that the Responsible Investment Guidelines developed by the Ministers responsible for the Target Funds integrate implementation of Responsible Investment methods particularly proscription or negative screening, company engagement and positive investment.*

Ensuring transparency and monitoring of the Responsible Investment approach of the Target Funds

As outlined earlier and through the Santiago Principles,[42] transparency and public disclosure of the investment policy and practice is preferable for SWF. As such, the Bill should specify that the Responsible Investment Guidelines to be developed by the Ministers responsible for the Target Funds should include provision for ongoing transparency and reporting of Responsible Investment policy and decisions, including an obligation to specifically report on measures taken to implement the Responsible Investment practices outlined by the Guidelines. As such, investors and the Australian public will be able to monitor the approach of the Target Funds, which further distances the Target Funds investment approach from any political partisanship of the Government of the day.

> *Recommendation 7: That the Bill be amended to require that the Responsible Investment Guidelines developed by the Ministers responsible for the Target Funds include provision for ongoing transparency and reporting of Responsible Investment policy and decisions, including an obligation to report specifically*

[39] Richardson, Benjamin J., 'Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand,' Nordic Journal of Commercial Law, Issue 2011#2

[40] NZSF, *Responsible Investment in Practice Report*, 2009, 9.

[41] *Ibid*

[42] International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds, Generally Accepted Principles and Practices: Santiago Principles (October 2008), available at http://www.iwg-swf.org/pubs/gapplist.htm

on measures taken to implement the Responsible Investment practices outlined by the Guidelines.

7 Further reading

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